COURSES OF STUDY IN CORPORATION FINANCE AND INVESTMENT

INVESTMENT BANKERS ASSOCIATION OF AMERICA

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IN CORPORATION FINANCE
AND INVESTMENT

Courses of Study in Corporation Finance and Investment

New York
Doubleday, Page & Company
for
Investment Bankers Association
of America
1917

INVESTMENT BANKERS ASSOCIATION OF AMERICA

Education Committee

Lawrence Chamberlain, Chairman

E. W. Bulkley A. W. Bullard

Preparation of material by

Hastings Lyon

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PREFATORY

About two years ago at the written request of several members of the Investment Bankers Association the Board of Governors appointed a Special Committee consisting of Lawrence Chamberlain, Chairman, E. W. Bulkley and A. W. Bullard, to consider the expediency of compiling and printing a text or texts of subject matter relating to the business of investment banking with the primary idea of assisting in the work of educating the relatively inexperienced bond salesmen in those things which can be taught from books.

As the work of the Committee progressed two things became evident: first, that the writing and printing of a series of text books would be too large an undertaking for this organization—at least at the present time—and second, that if it were desirable to undertake anything in the line of educational work the scope and purpose should be broadened to include suggestion and guidance to college and university instructors in finance.

Accordingly, the Committee so reported at the Convention held in October, 1916, at Cincinnati.

By an almost unanimous vote the members

of the Association in Convention requested a continuance of the work of the Committee and at a subsequent meeting of the Board of Governors, at which a comprehensive report with exhibits was presented to the Board, it authorized the Committee in its discretion to publish the material submitted in such form and under such arrangements as seemed desirable. The advent of America into the war and the necessary absence of the members of this Committee from their offices and regular duties in furtherance of the flotations of Liberty Bonds has delayed somewhat the completion of its work which otherwise would have been ready for the members in its entirety at the convention in Baltimore in November, 1917. The total plan of the Committee embraced the publication of outlines of six courses, a bibliography and a statement of the legal principles of a mortgage. The items referred to are as follows: (1) An outline of a course in Corporation Finance; (2) An outline of a course in Investment; (3) An outline of a course in Railroad Securities; (4) An outline of a course in Public Service Corporation Securities; (5) An outline of a course in Government and Municipal Securities; (6) An outline of a course on the Practice and Principles of the Stock Exchange; (7) A list of books on Investment Finance; (8) A statement of the Legal Principles of a Mortgage.

All of this work has been reduced to something like final form but since the Committee desired

its labors to be supplemented and revised by a number of specialists in the several topics treated, and since returns from all the specialists are not yet at hand, it has seemed best to prepare for publication at the time of the convention in Baltimore merely the first volume containing the outlines of the two general courses in Corporation Finance and in Investment which comprise this book. With this volume in the hands of all of our members and of many instructors in finance throughout the country it will be possible for the Committee to benefit by the frank and detailed criticism it hopes to receive so that the subsequent volumes may obtain the benefit of business practice and classroom experience.

The Committee thought that these outlines should be in considerable detail and fully annotated with references to available works in finance, so that even a man working without any personal assistance to get some knowledge of the subject might find careful direction for his endeavor. The Committee also thought that these outlines would furnish useful guides to any one, whether a bond house manager or a university professor, seeking to give instruction in those aspects of finance in which this Association is especially interested; and that they would help to standardize and establish on a sound basis a statement of the principles of finance without knowledge of which legislation affecting this form of business activity is likely to injure the welfare of the country.

Perhaps, also, the outlines will serve as an indication to the bond man of the amount of knowledge of principles and general information, as distinct from information about particular securities, that he ought to have as a basis for his work. The Committee has no thought that the study indicated will in itself produce competent bond men. The Committee is concerned only with that part of the bond man's equipment, whether it be of great or little importance, which consists of his general knowledge of investment.

HOW TO USE THE OUTLINES

These outlines have been prepared as an aid to the study of that branch of fiscal operations which has to do with financing fixed capital. It might properly be termed investment finance. The principles which should underlie these operations, however, are in the process of formulation, and those which have been determined are only incompletely stated in the books. Even the methods of this kind of finance have had a very limited description in printed form. The other large branch of fiscal affairs which has to do with financing circulating capital or "quick" assets (that is to say commercial banking), has for a much longer period been a subject for study and writing, and however much remains to be done to give it an adequate written treatment, the student in this branch has a comparatively well formulated and well des-

cribed science and art. It is the aim of these outlines to enable the man seeking a knowledge of investment finance to use existing books as advantageously as possible. They present a comprehensive scheme of study as far as the material is available. They have been prepared with the idea of bringing to his attention existing material in an orderly manner to develop the subject in a systematic way.

If the man who is undertaking to study the subject is working alone, he should purchase at least several of the books most frequently referred to. If he can get them all so much the better. The headings and sub-headings, the brief suggestive word or two in the outlines, indicate those matters in which he should be especially informed. The general references at the beginning of each numbered topic indicate sources of information generally for those matters suggested in the outline under that topic. Frequently after a heading or sub-heading of the outline the student will find a special reference. This reference already may have been included in one of the general references at the beginning of the topic, or it may be an entirely new reference selected from some book or from some part of a book in which there is not a general treatment of the entire topic. The special reference may refer only to the single heading or sub-heading immediately preceding it, or it may include several such headings or sub-headings between it and the next preceding reference.

Enough has been said already to indicate that these outlines are for the student rather than for the merely casual or even somewhat earnest reader. One who preferred, however, to take a book and read it through consecutively before taking up another book to read in the same way could advantageously use the outlines to test the knowledge he has gained from such reading. By looking through the outline he can see if he is informed on each heading, and how fully, and if he is not informed, how he can remedy his deficiency.

This suggests the use of the outlines by the man who has had experience in this branch of finance. It may be a waste of time for such a man to read all the material indicated. Some parts of the subject he may know much more thoroughly than any printed matter presents it. Such a man can go through the outlines and passing over that with which he is familiar round out his knowledge by doing the reading on those topics on which he is relatively uninformed.

An investment banking house interested in offering facilities for its men to increase their information might at least establish a little office library containing all the books referred to, and any of its men so inclined could make systematic use of the books with the assistance of the outline. The house may wish to go further and organize a class for study under the guidance of one of its more experienced men. The leader of the class in that event will find a

part of his work done for him through the systematic arrangement of the subject presented in the outline. The headings and sub-headings would afford him constantly the suggestion of the next matter to take up, and lead him on from subject to subject in an orderly manner. Almost any man of experience in a given field of work can talk interestingly and instructively about it if he has the suggestion of some specific subject out of the general field.

University instructors will find in the outlines a careful plan of courses of study in the subjects indicated which have been prepared under the supervision of men actively engaged in the financial work the courses present.

OUTLINE OF A COURSE IN CORPORATION FINANCE

This course assumes a general knowledge of the nature, organization, and management of corporations. The amount of information assumed is about that conveyed in Conyngton, "The Modern Corporation." It would be well to have read also Pratt's "Work of Wall Street," revised edition, and Sullivan's "American Corporation."

Full titles of books referred to will be found in the bibliography at the end of the outline

DIVISION I

INTRODUCTORY TOPICS

TOPIC I

Corporation Finance in Its Relation to the General Subjects of Economics and Accounting

This introductory topic forms the connecting link between general economics and business practice as presented in this course. A manager or other person in charge of the course can utilize the first session, for which the men have not had an opportunity for preparation, by giving a lecture covering this introductory matter. The bond man reading by himself could cover the ground by the references given. It would not be worth his while, however, to delay getting on. He had better get ahead and come back to these general references as he has opportunity. Some reference books in general economics are:

"Elementary Principles of Economics," by Irving Fisher.

"Principles of Economics," by Edwin R. A. Seligman.

"Principles of Economics," by F. W. Taussig.

The subject of Corporation Finance is closely associated with the subjects of Accounting and Corporation Law. The student would be helped greatly by some knowledge of both subjects. As suggestions for texts in accounting:

Cole: "Accounts, Their Construction and Interpretation."

"Modern Accounting," by Henry Rand Hatfield.

"Auditing Theory and Practice," by R. H. Montgomery.

"Net Worth and the Balance Sheet," by Herbert G. Stockwell.

For a book reference on the law of the subject, probably the most useful for a student would be:

Machen: "Modern Law of Corporations."

SUBJECT OF THE COURSE

This course discusses the financing of the relatively fixed capital of private business corporations.

Capital is wealth used in or useful for production.

CIRCULATING AND FIXED CAPITAL

Circulating capital is capital in the course of consumption. This is an economic term. The approximate business term is working capital.

Fixed capital is that capital which is relatively permanent.

ACCOUNTING IN RELATION TO:

Working (circulating) capital.

Quick assets.

Quick liabilities.

Lough, 105-130, 502-507.

Fixed capital.

Fixed assets.

Permanent or long term liabilities.

The following balance sheet of a manufacturing concern shows the accounting distinction between working (circulating) and fixed capital. The heavy type indicates the fixed capital asset and the italics indicate the liability items by which they were financed. The light type indicates the circulating capital assets and the liability items by which they were financed.

ASSETS

PLANT	$5,000,000
Merchandise and material inventory	750,000
Bills and accounts receivable	500,000
Cash	250,000
	$6,500,000

LIABILITIES

Common Stock	$3,000,000
Preferred Stock	1,000,000
Mortgage Bonds 5%	1,000,000
Bills and accounts payable	250,000
Surplus	1,250,000
	$6,500,000

THE INCOME ACCOUNT OF A MANUFACTURING CONCERN IN ITS ECONOMIC ASPECTS

Goods billed .	$3,500,000	The wealth produced.
Cost of material	1,250,000	The working (circulating) capital, the raw material increasing in value through the application of labor with the use of capital.
Maintenance, taxes and other current costs of production .	250,000	
Labor	1,250,000	The share of labor in the product.
Cost, other than cost of capital	$2,750,000	
Net	750,000	
Interest and Discount . .	125,000	The share of capital in the product.
Available for Dividends . .	$ 625,000	

FINANCE IN RELATION TO:

Working (circulating) Capital—is the field of Commercial Banking.

Fixed Capital—is the field of Corporation Finance and the subject of this course.

Question 1. The directors of a cotton mill corporation want to borrow $200,000, to buy bales of cotton. Would you consider that such financing came under the head of Corporation Finance as this syllabus has indicated the subject?

Question 2. The directors of the same corporation want to erect an addition to the plant that will cost $250,000. Would the provid-

ing of funds for this purpose properly form one of the considerations of this course?

Question 3. From what sources could the corporation procure the funds called for by question 2?

Question 4. How would the transaction be represented in each case in the Balance Sheet?

TOPIC II

Capitalization and the Investment Contract

The term "Investment Contract" is used to indicate the terms under which an investor commits his funds to an enterprise. The rights and obligations created, whether represented by a share of stock, a bond or other security, constitute the Investment Contract.

Lyon I, 1–49.

Chamberlain, 72–99.

Mead, 44–59.

Risk, Income, Control, as incidents of the Investment Contract.

Lyon I, 4–14.

The Proprietor.

Lyon I, 50–53.

The Creditor:
Unsecured.
Secured.

The Investment Contract as to the size of the commitment (denomination of the security).

Corporate securities as meeting the financial ability of the capitalist (investor).

Lyon I, 10.

The representative or fungible quality of corporate securities, *i. e.*, one share or obligation of a given issue just like another, facilitating market transactions.

Emery, "Speculation on the Stock and Produce Exchanges of the United States," pp. 38, 39, 74.

THE INVESTMENT CONTRACT OF THE STOCKHOLDER

Common stock.

Lyon I, 12.
Lough, 70.

Preferred stock:
- Cumulative.
- Non-cumulative.
- As to Assets.
- Special agreements.

Gerstenberg, 54–110.
Lyon I & II, 15.
Ripley, 95–100.
Lough, 71-82.

Participating stock.

Lyon I, 18.

Convertible stock.

Lyon I, 20.

Redeemable stock.
Lyon I, 25.

Some special stipulations of the Investment Contract of Stockholders.

Non-voting.
Lyon I, 28.

Vetoing.
Lyon I, 23-24.

Conditional voting.
Lyon I, 28.

Cumulative voting.
Lough, 95-99.

THE INVESTMENT CONTRACT OF THE CREDITOR

The unsecured creditor: Notes (Financial notes to be distinguished from commercial paper in that they are issued to finance relatively fixed capital).
Lyon I, 184, bottom.
Chamberlain, 75.
Ripley, 164-170.
Lough, 131-141.

Debentures.
Lyon I, 36–38.
Ripley, 141.
Lough, 149-154.

Equal security clause.
Lyon II, 218.

The unsecured creditor.
Lyon I, 74.

Mortgage bonds.
Lyon I, 36.

Income bonds.
Lyon I, 39.
Chamberlain, 75–76.
Ripley, 139.
Lough, 154-158.

Convertible bonds.
Lyon I, 43.
Ripley, 115.
Gerstenberg, 324–335 (reprint of special circular).
Lough, 158-160.

Redeemable bonds.
Lyon I, 181.

Question 1. How nearly like a bond can a share of stock be made? Indicate all the provisions you would put in a stock certificate to make it as nearly like a bond as possible.

Question 2. A corporation is capitalized and has earnings as follows:

$2,000,000 Common stock.
$1,000,000 6% non-cumulative preferred stock.

Earnings available for dividends, $80,000.

What criticism of the Investment Contract would you make from the standpoint of the preferred stockholder?

Question 3. A corporation is capitalized and has earnings as follows:

Common stock	$1,000,000
Preferred, 6% cumulative .	1,000,000
Debenture bonds, 5% . .	1,000,000
Net earnings	210,000

Assume that the present investment in the property amounts to $3,000,000. The directors are now proposing to increase the investment in the enterprise by selling at par $3,000,000 of six per cent. bonds secured by a mortgage on all the property of the company. Assume that the corporation will earn at the same rate on the additional as on the existing investment. What effect will the new bond issue have on the common and preferred stock and on the debentures? (Work this out specifically to show the result in figures.)

Assume that subsequently the corporation cannot earn more than four per cent. on the total investment. What is the result on all classes of securities? What would the result have been if the new bonds had not been issued?

TOPIC III

Capitalization and the Investment Contract
The Investment Contract of a Mortgage

FORM OF ORDINARY REAL ESTATE MORTGAGE

Gerstenberg, 176.

It is impossible to get any knowledge of Corporation Finance without a clear understanding of the nature of a mortgage and the relationships of the parties to it. The compiler of this syllabus knows from experience that many, even most, young men just beginning in business (and some older men) do not have any precise knowledge of the rights and liabilities involved in a mortgage. It is not desirable that the layman studying finance should seek the kind of an understanding of the field that the lawyer needs, but he must know the boundary points that determine the outline of the field. More than any other Investment Contract, the mortgage has influenced the development of methods of Corporation Finance. The corporate mortgage is only a development from the fundamental mortgage principles, and a study of a simple mortgage of a single piece of

real estate by an individual mortgagor to an individual mortgagee is the quickest way to get at the heart of the subject of corporate mortgage, mortgage bonds, the rights of bondholders, etc.

A mortgage is a conveyance (sometimes only a pledge) of the title to property to secure the repayment of a debt. The borrower retains possession of the property so long as he fulfils his obligation, and on completing his obligation he gets the title back. If the borrower fails to meet his obligations the lender may have the property sold to satisfy his claim.

The Debt—usually evidenced by:

Note or
Bond.

(Difference between note and bond. Bond an instrument under seal.)

Effect of seal. The corporate seal as a seal to create a "sealed instrument" and as a means of authenticating the corporate signature.

Secured by Mortgage:

Mortgagor—the borrower.

Mortgagee—the lender.

Mortgaged or pledged property.

Title.

Possession.

Covenants of the mortgagor (what the borrower agrees to do.)

Defaults (Failure of the mortgagor to keep his agreements).

Remedies of the mortgagee.

Release of the mortgage.

Transfer of the debt:

(The lender sells the note or bond to another who now becomes the creditor of the mortgagee.)

Assignment of the mortgage:

(The lender selling the note or bond transfers the mortgage claim against the property to the buyer of the note or bond.)

The mortgagor wants to sell the property:
(Sale may be free from the mortgage in which event the mortgagor must pay the debt.)

Sale subject to the mortgage:

If purchaser does not assume the mortgage, the property remains liable, but the purchaser does not become personally liable. If purchaser assumes the mortgage he becomes the principal debtor, and the seller remains liable as guarantor, unless released by the mortgagee.

Foreclosure and sale.

Deficiency judgment.

To trustee for benefit of bondholders.

Nature of a "trust." Trustee holds legal right but bondholders the beneficial interest.

Why to a trustee:

Otherwise would have to make each person lending funds one of the mortgagees with difficulties of transferring the security.

Question 1. A mortgages his house to B to secure a debt of $10,000. A fails to pay the debt and B forecloses. On the foreclosure sale the house is sold for $11,000. Who gets the extra $1,000?

Question 2. Assume that on the foreclosure sale the house sold for only $9,000. What are B's rights?

Question 3. A sells the house to C who takes it subject to, and assumes, the mortgage. A does not, however, get a release from B. C fails to pay the mortgage. On foreclosure the house sells for $8,000. C has only $1,000 of assets. What are B's rights?

TOPIC IV

The Basis or True Income Return of Bonds

Chamberlain, 403-415, 426-429.

The matter of the basis or so-called true income return on bonds often puzzles the beginner. It is well for him to become familiar early with the general principles involved so that he may readily grasp the ordinary discussions of the subject of finance which assume a knowledge of these concepts. An instructor might well convey in a lecture all the information required for this early preliminary consideration of the subject.

DISCOUNT BOND

A bond is an obligation carrying interest.

It may, however, be sold at a discount. *Chamberlain*, 407.

We have, therefore, in arriving at the real amount paid or received for the use of money in the case of a bond sold at less than par, a combination of the principles of interest and discount, as:

$1000. 5% 10-year bond at 95.		
Principal loaned, $950.		
Annual return received from coupons, $50.		
This (*i. e.*, $50 return on $950) is equivalent to an interest rate of .		5.26%
Amount returned to lender at end of 10 years	$1000.00	
But amount loaned	950.00	
Amount of discount for the 10-year period	50.00	
A correct calculation of the annual value of this would show it equivalent to a per annum return of approximately $\frac{37}{100}$ of 1 per cent.		.37%
		5.63%

It is not necessary for the student to go into the mathematical principles of what is variously termed net yield, net return, or true income return, comprising the annual value of interest and compound discount, involved in this computation until he gets into the course in Investments.

PREMIUM BOND

A bond may also be sold at a premium. *Chamberlain*, 409.

$1000. 5% bond, running for 10 years at the price of 105.		
Principal loaned	$1050.00	
Annual return received from coupons	50.00	
This would be a per cent. of		4.762
But amount returned to lender at end of ten years is	1000.00	

This is less than the principal loaned by	50.00	
This amount of principal has been paid back to the lender in the period.		
A correct mathematical calculation of the value of this shows that it is equivalent to an annual per cent. of approximately $\frac{387}{1000}$ of 1%		.387
Which is the computed annual amount compounded at the basis rate of 4.375 required to amortize the premium leaving a net return of approximately		4.375

THE USE OF THE BASIS BOOKS

Chamberlain, 426-429.

Question: Determine from a basis book the approximate yield of the following bonds:

YEARS TO RUN	RATE OF INTEREST PER CENT	PRICE
25	5	95
20	3½	85
12	4½	98
15	6	105
18	3	103
40	4	95
5	5	97
3	4½	101
35	6	95
50	4	92

DIVISION II

CAPITALIZATION IN RELATION TO INCOME, ASSETS, STATE CONTROL

TOPIC V

Capitalization in Relation to the Income Account, Part I

Lyon I, 50-56.
Lyon II, 175–195.
Chamberlain, 263, 279.
Lough, 179-189.

Unless the student is familiar with matters of accounting, the instructor will need to explain fully the terms involved in the Income Account, and the student working by himself will need to feel that he has a sound understanding of the Income Account.

THE INCOME ACCOUNT

For Railroads and Public Service Corporations.
Lyon II, 175–179.
Gerstenberg, 166.
Chamberlain, 263–275.

SHORT FORM		LONGER FORM
Gross Income		Operating Revenue: (Classified according to kinds of business carried on)
Operating		Operation Expense: Conducting operations Maintenance
Net Income		Net Operating Revenue Taxes Income from other sources
	Deductions from Income	
Fixed Charges	Interest Rentals	Also requirements for amortization of discount and of debt
	Available for Dividends	
Surplus	Dividends Surplus	
	Contingent Liabilities	
		Concealing additions to the capital account through maintenance

Concealing additions to the capital account through maintenance.
Lyon II, 182.

Skimping maintenance.
Lyon II, 182.

Income account of an industrial corporation.
Lyon II, 186.
Gerstenberg, 662, 782.

Shipments billed.
Cost of shipments:
 Cost of materials.
 Cost of manufacturing and selling.

Maintenance.
Net manufacturing profit.
Other income.
Total net.
Interest and other fixed charges.
Surplus for dividends.

Question 1. A corporation is making gross earnings of $756,000, net earnings of $325,000. What is the operating ratio?

Question 2. A corporation is earning gross $1,845,962. The operating ratio is 70 per cent. Fixed charges are $225,000. (*a*) What amount is available for dividends? (*b*) By what percentage are the earnings in excess of fixed charges?

Question 3. The corporation indicated in question 2 has $1,000,000 6 per cent. preferred and $1,000,000 common stock. What per cent. is it earning on the common?

Question 4. A corporation has the following Income Account:

Gross	$6,000,000
Operating	4,000,000
Net	2,000,000

Its capitalization is:

First mortgage 6 % bonds . . .	$4,000,000
General mortgage 4½% bonds . .	5,000,000
Debenture 5% bonds	6,000,000
Preferred stock 6%	7,000,000
Common stock	10,000,000

(a) What is the operating ratio?
(b) What are the fixed charges?
(c) How much is available for dividends on the preferred stock?

(d) What percentage is that on the preferred?

(e) How many times the amount required for preferred dividends is it?

(f) How much is available for dividends on the common stock?

(h) How much is available for interest on the 1st mortgage 6% bonds? How much required?

(i) How much is available for interest on the general 4½% bonds? How much required?

TOPIC VI

Capitalization in Relation to the Income Account. Part II

Lyon I, 56–82.

Relative liability of different classes of business to variations in gross income.

Railroads.

Public Service Corporations.

Industrials.

Lyon, 56–68.
Ripley, "Railroad Rates and Regulation," has some interesting matter on this subject:

Tendency of operating ratio to increase on declines in gross and effect on net income.
Lyon, 56–68.

Providing business capital by borrowing.
Lyon, 50–53.
Ripley, 105–109.

Borrowing limited by liability of net earnings to fluctuate.
Lyon, 54.

Earnings available for interest, and the margin of safety.
Lyon, 54.
Chamberlain, 276.

Question. The X. Y. corporation has a gross income during a prosperous business period of $1,000,000. Its operating ratio is 70 per cent. It is subject to a decline of 20 per cent. in its gross during a period of depression and to an increase in the operating ratio at the same time of 5 per cent. Can it safely have a bond issue of $4,000,000 of 5% bonds?

TOPIC VII

Capitalization in Relation to Assets. Part I

Lyon I, 83–107.
Ripley, 227–237, 248–255.
Mead, 145–158.
Lough, 172-179, 189-200.

The issuance of securities for a consideration not really worth the par of the securities.

Sale of bonds at a discount is equivalent to borrowing at a higher interest rate, *i. e.*, a combined interest and discount transaction involved in the borrowing.

The issuance of stock when the consideration received does not really have a value equal to the par of the stock called stock watering.

Common Objections to Stock Watering.
Lyon I, 83–85.

Fraud on the buyer.

As a means of concealing excessive charges.

Proper Purposes of Stock Watering.
Lyon I, 86–107.

As a means of arriving at a bargain—satisfying the various interests.

Special use for this purpose in carrying out underwriting transactions.

What advantages there may be to the corporation in financing with watered stock.

Giving par value to stock illogical.

Stock without par value the better way.

A New York statute permits it (on minimum paid in of $5 a share) and Maine, Delaware.

(New York Stock Transfer Tax—especially important because of transactions on N. Y. Stock Exchange—Stock without par value taxed 2 cents a share, the same as $100 shares.)

See also statutes of Virginia, West Virginia. *Lough*, 95.

Question 1. A mining corporation issues its stock with a par value of $100. Its entire capitalization is $1,000,000 of common stock, and $1,000,000 in cash was paid to the corporation for this stock, and used in the purchase of the mine, equipment for working capital, etc. The ore has been carefully blocked out, and it is estimated that at the rate of working anticipated the ore will last 15 years. The mine is worked 5 years at the expected rate, and everything tends to show that the property was just worth the price paid for it. What is the value of the stock at the end of 5 years?

Question 2. Certain real estate with an actual value of $250,000 and cash in the amount of $250,000 were turned over to a newly formed corporation for $750,000 par value of the stock of the corporation. The corporation expended the $250,000 in cash in erecting a loft building. Now, ten years later, the plot of land, without considering the value of the building, has an actual value of $750,000. (*a*) What was the original relation of assets to par value? (*b*) What is the relationship now? (*c*) The promoters anticipated this increase in land value. Were they justified in capitalizing as they did?

Question 3. The X. Y. corporation issued its $1,500,000 of common stock, and received for it land worth $1,000,000 and $500,000 in cash. Ten years later the land was worth only $500,000. Other assets were worth $500,000. Should the corporation reduce the amount of its stock outstanding?

Question 4. The promoters of a corporation have $1,000,000 to invest in the enterprise. They want to keep control. The enterprise, however, requires $3,000,000 of capital. It is of such a character that not more than one-third of the capital should be represented by bonds. The promoters have options on certain properties for which they will have to pay $500,000. Development will use up the rest of the required funds. The promoters want their cash contribution repre-

sented by the same kind of security as the cash contributed by any one taking any security except bonds. Suggest a capitalization and distribution of securities that will meet these requirements.

TOPIC VIII

Capitalization in Relation to Assets. Part II

Lyon, 83–107. (Same as previous topic.)
Mead, 60–74.

Relation of value of assets to amount of earnings.

Equity above the mortgage:

Stipulations to keep the equity good;

Stipulation for maintenance to keep the value of the assets unimpaired;

Stipulation for the reduction of the debt (see special topic "Amortization," under topic XIX).

The open mortgage—authorized and unissued bonds:

Lyon, 113.
Heft, 69–71, 239–241 (Definition of "open" mortgage not in accord with accepted usage.)
Mead, 65–72. (Especially good treatment of this topic.)

How will the future issuance affect the equity? Stipulations tending to maintain the

equity as bonds to be issued only for a certain percentage of the value of new assets or bonds to be issued only on the retirement of senior bonds.

Junior mortgages placed after open mortgages. Stipulation in the junior mortgage that no more bonds shall be issued under the open mortgage.

Junior mortgage placed after a mortgage maturing earlier than the junior mortgage. *Heft*, 272.

Expectation of not having the prior claim ahead of it after the maturity date of the prior claim.

Possibility of extending the maturity of the prior debt, and stipulations in the junior mortgage against it.

Question: The X Corporation

Value of Assets	6% First Mortgage Bonds Issued and Outstanding
$3,000,000	$1,000,000
	Authorized and Unissued $1,000,000

Net Income:
Twelve months just past, $300,000.
Preceding twelve months, $290,000.
The Trustee is authorized to certify the unissued bonds on the following conditions:

(*a*) That the earnings for each of the two preceding twelve-month periods are at least three times the interest charge on the bonds outstanding and those to be issued.

(*b*) That the par of the additional bonds is not in excess of 75 per cent. of the cost of additional assets required by the corporation.

The directors want to erect and equip a new building at a cost of $800,000.

1. How many bonds can they issue to reimburse the cost of the new assets?

2. What percentage of the value of the assets is the present mortgage debt?

3. What percentage of the value of the assets will the mortgage debt be when the additional bonds are issued to pay for the new plant?

4. What percentage of the value of the assets would the mortgage debt be if all the authorized bonds were issued?

TOPIC IX

Capitalization in Relation to the State

Lyon I, 220–283.
Ripley, 281–312 (Very full treatment of the subject for railroads.)
Mead, 75–80.
Gerstenberg, 337–349. (New Jersey Public Utilities Act) 351–357. (General principles regulating action by the Public Utility Commission of New Jersey upon petitions asking approval of proposed issues of securities.)

Public Service Commissions and their functions.
Lyon I, 240.

Regulations of:

Rates.

Service.

Securities.

Accounts.

Competition.

Public Service Commission. Control of Capitalization.

Certificate of public convenience and necessity.
Gerstenberg, 345 (24).

Capitalization in relation to valuation.

Bases of valuation.
Lyon I, 233–239.

Investment.

Replacement.

Reproduction.

Authority and Determination of the Commission on:

The amount of securities to be issued.

The purposes for which issued.

The terms on which issued.
Lyon, I, 248–259.

DIVISION III

FINANCING NEW CAPITAL ASSETS—THE FINANCING THROUGH AND OF HOLDING COMPANIES AND SUBSIDIARIES—COMBINATIONS AND MERGERS—INTERCORPORATE RELATIONSHIPS—THE FINANCING OF SPECIAL ASSETS, I. E., SUCH AS EQUIPMENT—SPECIAL USES OF THE COLLATERAL TRUST

TOPIC X

Intercorporate Relationships

Mead, 255–278.
Mead, 325–331.
Mead, 338–347.
Ripley, 143–147.
Gerstenberg, 522–554. (Consolidation agreement.)
Gerstenberg, 590–619. (Sherman Act, Clayton Act, Trade Commission Act.)

Financing new capital assets.
Mead, 255–278.

Intercorporate Financial Relationships: The Collateral Security.

Authority of one corporation to own stock or other securities of another.

Limitations imposed by anti-monopoly law.

The operating corporation and the holding corporation.

A corporation may be an operating company only.

A corporation may be a holding company only.

A corporation may be both an operating and a holding company.

Class of securities of one corporation owned by another:

May own stock alone.

May own bonds alone.

May own stock and bonds.

Amount of securities of one corporation owned by another giving rise to various situations:

May own all the stock.

May own a majority of the stock.

May own less than a majority of the stock but enough to effect actual practical control.

May not own enough to control.

May not own all the bonds or may own all the bonds of one issue when more than one issue.

May own only part of bond issue.

If corporation owns a controlling amount of stock of another combination, or if less than a controlling amount but still an important minority, an intercorporate relationship exists; if corporation owns an unimportant minority, merely an investment.

Community of interest.
Ripley, 424.

Corporation providing the funds may use its own credit to sell its own bonds to provide the funds. (It may pledge under a trust deed the stock or other securities it receives of the corporation to which it is providing the funds. This is the collateral bond.)

The collateral bond.
Mead, 325–331.
Ripley, 143–147, 156.

If a general obligation of the issuing corporation and secured only by pledge of stock or bonds, a pure collateral bond.

Bond may be secured by mortgage on tangible property and also by pledge of stocks or bonds.

An interesting problem on Consolidation may be found in "Cole's Accounts," pp. 346-51.

TOPIC XI

The Future Acquired Property Mortgage

Lyon I, 108–143.

The future acquired property mortgage:

Why created—demand of the capitalist in bargaining over the Investment Contract.

Effect on future financing of corporation whose assets covered by future acquired property mortgage.

Cannot give first lien on new asset to finance its acquisition unless bonds are redeemed through purchase or call.

Lyon I, 114.

Creation of new corporation to finance acquisition of new asset.
Lyon I, 120.

Parent corporation provides funds to the subsidiary: takes stock and bonds of subsidiary (discussed in previous topic).

Parent corporation reimburses itself entirely or in part by:

(*a*) Selling bonds of subsidiary;

or

(*b*) Guaranteeing and selling bonds of subsidiary (sell at a higher price by reason of the guaranty);
Lyon I, 122.

or

(*c*) Selling its own bonds secured by pledge of bonds of subsidiary.
Lyon I, 122.

Since a lien now attaches to subsidiary, parent corporation may acquire assets of subsidiary subject to the lien.

Use of the open collateral trust mortgage to finance acquisition of series of new assets.
Lyon I, 124–126.

Question: The X. corporation runs a little railway line from Y to Z. It is a narrow-gauge road, and the directors have decided that it would be profitable to convert it into a standard-gauge property and lay heavier rails. This will require about $1,000,000.

Present Capitalization:

Common Stock	$2,000,000
First mortgage 5% bonds, mortgage closed	1,000,000
Net earnings	135,000

How could the directors provide the new capital?

TOPIC XII

The Holding Company: Financial Combinations

Lyon II, 196–210.
Ripley, 412–418; 420–455.
Mead, 348–374.
Lough, 49-54.

Holding company may be pure holding company, *i. e.*, not conducting any operations of its own.
Ripley, 433–455.

Company conducting operations of its own may be used as a holding company.

Acquiring control of subsidiaries by swapping stock of holding company.
Lyon I, 127.

Acquiring control of subsidiaries by purchase of stock.

Funds for purchase provided by sale of holding company stock.
Lyon I, 127.

Sale of holding company bonds unsecured by specific pledge of subsidiary stock.

Secured by pledge of subsidiary stock.
Lyon I, 128.

Existing liens of subsidiaries.

Possible creation of new liens on subsidiaries.

Disadvantage of this to bondholders or preferred stockholders of holding company.
Lyon II, 203–205.

Stipulations against this in the investment contract of the preferred stockholders or bondholders of the holding company.
Lyon II, 206.

Pyramiding for control by use of the holding company.
Ripley, 524–532.

General consideration of the income of holding companies.
Lyon II, 196–210.

Control through the same stockholders.
Ripley, 423.

Combinations of Public Utilities:

Unity of Management.

Central Power Plants.
Gerstenberg Materials, 570–582. (Advantages claimed.)

Combinations in industrials.

Combinations in railroads:

(There is a large amount of material on the subject of trusts. Most of the argument, however, relates to the economic and not to the financial aspects of combinations and is not germane to a course in Corporation Finance.)

Financial arrangements on dissolutions of solvent corporations (*i. e.*, to comply with anti-trust legislation).

Gerstenberg, 1001–1008 (Dupont Co. dissolution).

TOPIC XIII

Financing a Combination by Means of the Lease; Special Financing of Union Terminals; Special Uses of the Collateral Trust Agreement

Lyon, 131–136.
Mead, 375–384.
Ripley, 418–421.
Gerstenberg, 556–569 (example of a corporate lease).

The lease by one corporation of the property of another corporation:

Authority to lease.

Why the lease resorted to:

Avoids the raising of capital to finance the purchase of assets. An annual fixed charge (rental) instead. Sometimes easier to negotiate than a purchase.

Terms of the lease:

Maintenance of the leased property. Payment of an amount of rental equal to fixed charges and a percentage return on the stock of the lessor corporation.

Guarantee of interest and dividends.
Lyon I, 133.

Position of lease in receivership.
Lyon I, 132; II, 227.

FINANCING OF UNION TERMINALS

Lyon I, 141–143.

Terminal property owned by terminal corporation.

Owning corporation leases property to entering railroads.

Rental—an agreement to pay rent sufficient to give a return on capital investment, *i.e.*, an amount equal to fixed charges, etc.

REALTY FINANCING

Chamberlain, 366-372.
Lyon I, 139.

Use of the collateral trust to finance real estate loans.

Deposit of real estate mortgages and uniform issue of bonds against them.

Federal Farm Loan Banks.

TOPIC XIV

Special Financing of the Purchases of Railroad Equipment

Chamberlain, 292–300. (Full treatment.)
Cleveland and *Powell*, "Railroad Finance," 81–94
Ripley, 171 (brief).

Financing the purchase of railway equipment by giving the lender a special claim on the equipment:

The future acquired property mortgage prevents this being done directly.

Railroad makes contract with manufacturers for equipment; assigns contract to third party who makes conditional sale of equipment to railroad for series of notes (bonds) of railroad with title of equipment to pass to railroad when all notes are paid. Equipment mortgaged to secure notes.
Lyon I, 149; II, 227.

Conditional sale:

Conditional sale and chattel mortgage recording acts.
Special state acts.

Equipment bonds issued up to per cent. of cost of equipment.

Railroad makes first cash payment of difference between par of the bonds authorized and cost of equipment.

Railroad's covenant to replace damaged, lost, or destroyed equipment, etc.

Philadelphia Plan:

Equipment leased (not sold on conditional sale) to railroad.

Leases deposited with trustee who issues trust certificates against them.

Tax exemption in Pennsylvania.

Serial maturity of equipment securities and depreciation of equipment.

TOPIC XV

Stock: Its Issuance and Sale

Lyon II, 1–34.
Mead, 91–117.
Ripley, 268–274. (Check up with the reference to Lyon on the legal requirements.)

(It should be noted that this is almost entirely a legal topic. Precisely what may be done depends on the law of the particular jurisdiction. This course can discuss the subject only in its broad general outlines):

Stock, authorized, issued, outstanding.

Authorized issue:

Classes.

Issuance of stock:

Subscription for.

Part paid and full paid.

Payment for stock:

By money, services, or property of the value of the par of the stock.

Valuation of property paid for by stock.

Treasury stock:

Difference between authorized and unissued stock and treasury stock.

Not an asset of the corporation.

How stock is sold for less than par:

Treasury stock—corporation may sell at any price.

Stock dividend: If the corporation has a surplus may declare it out in a stock dividend and stockholders pool their holdings to issue to the public. (For more of this see under the "Readjustment of the Capital Account" topic XXIX.)

Stock without par value.

Lyon I, 84.

Rights of stockholders to new issues of stock:

Right to subscribe at par (or in some jurisdictions at a price stated and not to be sold at a lower price).

Value of rights to subscribe.

Equivalent to dilution of surplus.

Underwriting an issue of stock:

May be sold to bankers or public when treasury stock.

On issue of corporation not sold but underwritten.

Increasing the amount of stock authorized.
Decreasing the amount of outstanding stock.
The issuance of stock on conversion.

Ripley, 276.

Question 1. A corporation has $1,000,000 outstanding, $2,000,000 authorized and unissued stock. A capitalist who is familiar with the affairs of the corporation offered to buy 500 shares of the authorized and unissued stock at $115 a share. The corporation wanted the money and the price was a fair price for the stock. Could the directors accept the offer?

Question 2. The X corporation announces that stockholders of record on the 1st of April will have the privilege of subscribing to $1,000,000 of new stock of the corporation at par.

(*a*) The corporation has stock issued and outstanding of $5,000,000. A owns 25 shares of stock. How much of the new stock will he have a right to subscribe for?

(*b*) A transfers his stock on the 25th of March to B by giving him a new certificate made out in the name of B. Who has the right to subscribe to the new stock?

(*c*) On the 2d of April the stock of the corporation is quoted at $125 a share. What is the value of the right accruing to one share of the old stock?

(*d*) Assume that the stock of the X corporation is selling at $150 at the time of the announcement of rights. What should it sell for when it goes "Ex-rights"?

TOPIC XVI

Stock: Its Form and Transfer

Lyon I, 166–173.

The stock certificate:
- Face of the certificate.
- Power of attorney.
  - Power of substitution.
- The certificate book:
  - The stub.
- Transfer agent.
- Registrar of transfers.

The stock book:
- Holders of record.
- Dividends to holders of record.
- Closing book over dividend period.

Good delivery.
(Rules of Committee on Securities, New York Stock Exchange.)

Regulations regarding transfer.
Transfer tax.
Subscription receipts.
Interim certificates.

TOPIC XVII

Bonds: Their Issuance Form and Transfer

Lyon I, 173–199.
Mead, 299–324.

Authority to issue bonds:

Not limited by charter (ordinarily).

Special statutory limitations (as that debt shall not exceed amount of stock).

Borrowing and mortgage authorized by stockholders.

Certification and Issuance:

Execution and authentication of bond by signatures of officers and seal of corporation and certification of trustee.

Conditions under which bonds may be issued stated in the investment contract (trust deed mortgage).

Bonds redeemed after issuance are "dead" bonds and if reissued create a different debt, *i. e.* not with the same mortgage lien as outstanding bonds.

Hold by a trustee if to be kept alive for sinking fund or otherwise.

Terms of the bond:

- Maturity.
- Denomination.
- Interest rate.
- Interest dates.
- Registered and coupon:
  - Registered as to principal.
  - Interchangeable.
- Place of payment (Domicile).
- Payment in different monies.
- Prior redemption right.

Bonds: Their transfer:

- Coupon by delivery.
- Registered—by transfer on books of corporation.
  - Rules of transfer.
- Subscription receipts.
- Interim certificates.
- Temporary bonds.
- Definitive bonds.

TOPIC XVIII

The Corporate Mortgage and Trust Deed

Heft, 56–145.
Gerstenberg, 183–254. (Reproduction of one corporate mortgage.)

Recitals:

Incorporation, authorization of bonds and mortgage, form of bonds, coupons and authentication.

Granting clause:

Description of property mortgaged or pledged.

Issuance of bonds (with execution, authentication and registration clauses).

Conditions under which bonds may be issued:

Bonds to be issued immediately.

Bonds reserved for refunding, or for the acquisition of additional assets, and conditions under which the trustee may certify bonds for issuance.

Provisions for redemption:

Sinking fund. Rights of redemption before maturity.

Covenants of the corporation.

Agreements for maintenance, insurance, etc., against the issuance of further securities by subsidiaries whose securities are pledged. (In case of trust deed for debentures, against the creation of prior claims.) Covenants relating to the control of pledged securities. Provisions for audits, dividend payment, restrictions, etc., etc. General legal covenants.

Remedies of trustees and bondholders, and special law clauses:

Law covenants stating rights under the mortgage.

Releases of mortgaged property. Defining the duties and protecting the trustee. Execution and recording of the document.

The corporate mortgage an elaborate investment contract.

TOPIC XIX

The Maturity of the Debt

Lyon I, 144-165.
Gerstenberg, "Syllabus," 30, 31.
Mead, 81–90.
Ripley, 130–132 (brief).

An extension of the debt may be had by agreement.

Chamberlain, p. 101, Par. 293; p. 111, Par. 340.
Heft, 327.

Position of junior lienor on extension of debt with senior lien.

Covenants in junior lien agreement that senior lien debt will not be extended.

Refunding:

The refunding mortgage.

Burden of the debt (*i. e.*, the annual charge, against the corporation for interest and sinking fund or serial maturity).

Lyon I, 152.

Amortization of the debt:

Serial maturity.

Special sinking funds.

Repurchase of securities:

Reserved right of redemption.

Keeping bonds alive in the sinking fund.

Tests of amortization provisions:

1. What assurance that amortization provisions will be carried out?

2. How will they affect market?

3. How evenly do they distribute the burden of the debt?

4. Work involved in carrying out provisions.

5. Assurance that provisions equal requirements.

6. Cost.

TOPIC XX

The Corporate Income and Its Disposition

Lough, 415-434, 465-481. (A good discussion.)
Lyon I, 173–208.
Chamberlain, 263–279.
Ripley, 238–247. (On disposition of the surplus.)
Mead, 171–254. (An especially full discussion.)

Gross income. Income from operation. Income from outside operations and other income.

Income from operations—its liability to fluctuation.

Income from the ownership of securities—character of this income.

Income of the holding company:

Influence of liens on the subsidiaries.

Cost of conducting operations:

Efficiency of plant.

Efficiency of management.

Cost of maintenance:

Is enough being expended to maintain efficiency of plant?

Are net earnings being shown at the expense of maintenance?

Are expenditures on the capital account being charged to maintenance?

Taxes—the taxation of corporations.

Lyon, "Principles of Taxation," 113–119.

Net earnings and fixed charges.

Disposition of the surplus income.

Policy of building up a capital surplus and its relation to the maintenance of dividends.

Gerstenberg, "Syllabus," 62.
Ripley, 238–247.
Lough, 422-434, 465-481.

Reserves.

Lough, 422-428.

TOPIC XXI

Declarations and Payments of Dividend

Lough, 425-464.
Mead, Chap. 17, 18.

Directors declare dividend:

Power of directors over dividend declaration.

To stockholders of record at a certain date.

When paid.

Closing of books to make up the record.

Transfer of certificate while books are closed—who gets the dividend?

Quotations—ex dividend.

Extra dividends: Special dividends.

Stock dividends:

(Purpose treated more fully later under readjustment of the capital account topic XXIX.)

Distribution of surplus:

(Dilution of surplus—lessening of surplus

per share of stock through subscription rights).

Dividend warrants.

Accumulated dividends on cumulative preferred stock.

May be good business for the common stockholder to let preferred dividends accumulate, getting use of money for nothing.

Rights of preferred and common stockholders in distribution of surplus.

DIVISION IV

THE DISTRIBUTION OF SECURITIES

Lyon, 35–101.
Mead, 118–144.
Lough, 201-228, 291-318.

TOPIC XXII

The Sale of Securities by the Corporation

Direct to the public.

Why not successful.

To its own stockholders.
Lyon II, 15.

Underwriting the sale.
Lyon II, 17.

To investment bankers.
Lyon II, 2.
Lough, 319.

Selling to the corporation's own stockholders.
Stockholders' "rights."
Gerstenberg, 358–366.
Lough, 298-308.

Selling to investment bankers.

Appraisals—engineer's report.

Gerstenberg, 457-488.

Audits—expert accountant's reports.

Legal opinions:

Title to property.

Legality of procedure for issuance.

Sales at auction—Public Service Corporations.

Lough, 308-310.

TOPIC XXIII

Syndicates: The Joint Account

Lyon II, 102–156.
Lough, 339-353.

Financing the purchase of securities by the investment banker.

Coöperation in the purchase and sale of securities.

For greater banking power.

For greater selling power.

Formation of the joint account.

The syndicate manager.

Purchase of the securities by the syndicate.

Members' contribution to price—members' capital and borrowed capital.

Carrying the securities:

Undivided carrying.

Divided carrying.

The syndicate price.

Releasing securities as collateral for the loan in order to make deliveries.

The take down price, or price of purchase by the selling member from the syndicate.

Effect in keeping profits undistributed.

Broker's commission.

Members' selling commission.

Territory.

Advertising.

Duration of the account.

TOPIC XXIV

The Joint Account: Distribution of Profits and Losses: Underwritings

Lyon II, 102–156.
Mead, 159–170.

Unlimited (or undivided) liability accounts:

Distribution of profits.

Distribution of unsold securities or of losses.

Limited (or divided) liability accounts:

Distribution of profits and of unsold securities or of losses.

The underwriting as a form of the syndicate, to be distinguished from the use of the term as an assurance against loss on a sale by the corporation in lieu of a purchase for which see Topic XXII.

The formation of a second syndicate to purchase from the first syndicate or original purchaser:

Restricted and large underwriting groups.

Application for the underwriting.

Allotments of subscriptions.

TOPIC XXV

Work of the Bond Houses

Chamberlain: Work of the Bond House. (Entire).
Lyon II, 35–101.
Lough, 319-328.

Selling securities by the investment bankers.

Organization of an investment banking house.

Negotiating, investigating, statistical, executive, buying, selling, accounting, and record keeping departments.

Work of the statistical department, analyses, preparation of circulars, etc.

Work of the cashier's (accounting) department:

Receiving and delivering securities.
Taking care of loans, substitutions, etc.
Keeping accounts.

Work of the selling organization:

Mailing list.

Circulars.

Work of the securities salesman:

Selection and training of salesmen.

Territory and methods of work of salesmen.

Work of the banking house in creating and supporting a market

TOPIC XXVI

Listing Securities On and Selling Them Through the Stock Exchange

Lyon II, 157–174.
Chamberlain, 62–68.
Gerstenberg, 162–170. (An application for listing.)
Lough, 328-338.

Reasons for and against listing an issue of securities on the stock exchange.

Listing requirements:

Application to committee on the stock list.

Expense.

Location of transfer agent and registrar of transfers.

Mechanical preparation of securities.

Documents required.

Other information required.

Promotions.

Mead, 14–24.
Gerstenberg, 457–468. (An engineer's report for a promotion.)
Gerstenberg, 499–521. (An agreement to purchase assets, etc.)

DIVISION V

THE CORPORATION IN FINANCIAL DIFFICULTIES, RECEIVERSHIPS, BANKRUPTCIES, REORGANIZATIONS, READJUSTMENT OF THE CAPITAL ACCOUNT, RECAPITALIZATION

TOPIC XXVII

Receiverships and Reorganizations

Lyon II, 220-307.
Ripley, 371–388.
Mead, 406–426.
Cleveland & Powell "Railroad Finance," 227–270.
Lough, 573-592.

Default and application for receiver.

Financial management of property in receivership.

Receivers' certificates.

Protective committees:

Powers.

Calling for deposit of securities:

Depositaries.

Certificates of deposit.

Listing.

Policy of security holders with regards depositing.

Foreclosure suit.

Appraisal and auditing.

Books that should receive special mention in connection with the subject of reorganization are:

"Railroad Reorganization," by Stuart Daggett, which is a study of various railroad reorganizations.

"Corporate Promotions and Reorganizations," by Arthur S. Dewing, which is a study of the promotion and reorganization of various industrial enterprises.

"Some Legal Phases of Corporate Financing, Reorganization, and Regulation," by Stetson, Byrne, Cravath, Wickersham, Montague, Coleman, and Guthrie, is a book of great value. Though primarily for a lawyer, a man who is studying the financial aspects of these topics can get much of value from it.

TOPIC XXVIII

Reorganizations

Readjustment of the capital account recapitalization.
Lyon, 220-307. (Same as previous topic.)
Heft, 335, 404.
Ripley, 338–411.
Mead, 427-460.
Lough, 593-606.

The financial plan of reorganization.

Filing reorganization agreement.

Giving depositors an opportunity to withdraw.

Declaring plan operative or inoperative.

Extension of time to deposit.

Decree of foreclosure.

Upset price.

Provision for cash requirements:

Assessments.

Sale of new securities.

Underwriting and purchasing syndicate.

Readjustment of the capital account recapitalization.

Lyon, 296-307.
Mead, 365–405.
Gerstenberg, "Materials," 910–934. (Recapitalization of Chicago & Alton.)
Gerstenberg, "Materials," 935–965. (Readjustment of debt, Hudson & Manhattan R.R. Co.)
Gerstenberg, "Materials," 966–1000. (Reorganization of B. & O.)

Distribution of securities on dissolution under Anti-Trust Act.

Gerstenberg, 1001–1008. (Dupont Powder Co.)

TOPIC XXIX

Promotions

Lough, 229-290.
Mead, 14-24.
Gerstenberg, 457-468, 499-521.
Cooper, "Financing an Enterprise."
Gerstenberg, "Syllabus," Chapter XV.

Requisites of a successful enterprise.
Cooper, 27-47.

A sound undertaking.
Sufficient capital.
Efficient management.

A sound undertaking:

Investigation.

(Industrial enterprise)

Basis of enterprise.
Title to property.
Cost of construction.
Capacity and market.

Environment.

Conditions of operation.

Lough, 229-240.
Cooper, 48–65.

Investigation.
(Transportation enterprise)

Cleveland & Powell, 14–19.

Basis of enterprise:

Population, capital, and resources.

Survey (for advantageous operating and cost of construction).

Grades, curvature, and cost of right of way.

Charter.

Investigation:
(Gas, electric lighting, street railway.)

Basis of enterprise:
Population and area.

Cost of production and market at price that will produce a profit.

Assembling and preliminary financing.
Lough, 240-249.

Who act as promoters, legal status.
Lough, 250-264.

Promoting combinations.
Lough, 265-290.

BOOKS REFERRED TO IN THE OUTLINE OF A COURSE IN CORPORATION FINANCE

BYRNE—*Some Legal Phases of Corporate Financing*, New York Bar Association Lectures—Byrne, Stetson, Cravath, Wickersham, Montague, Coleman, Guthrie, New York, 1917, MacMillan, $2.75.

CHAMBERLAIN—*The Principles of Bond Investment.* By Lawrence Chamberlain, 1911. New York, Henry Holt & Company, $5.00 net.

CHAMBERLAIN—*The Work of the Bond House*, New York, 1912, Moody's, $1.00.

CLEVELAND—*Railroad Finance.* By Frederick A. Cleveland and Frederick Wilbur Powell, New York, D. Appleton & Company, $2.75 net; by mail, $2.95.

COLE—*Accounts, Their Construction and Interpretation.* By William Morse Cole, Professor of Accounting, Harvard University. Revised edition, 1915. Boston, Houghton Mifflin Co., $2.50.

COOPER—*Financing an Enterprise.* By Francis Cooper. Fourth Edition. 1915. New York, Ronald Press Co., $3.00.

CONYNGTON—*The Modern Corporation.* By Thomas Conyngton. A condensation of the matter contained in the larger corporate works of Conyngton. 1913. New York, Ronald Press Co., $2.00.

CONYNGTON—*Corporate Management.* By Thomas Conyngton. Covering the legal management of cor-

porations after they are in operation. Details the procedure under the charter and by-laws, recording the minutes, transfer of stock, rights, powers, and responsibilities of stockholders, directors, and officers with forms for minutes, motions, resolutions, reports, stock certificates, etc.—Third edition. 1911. New York, Ronald Press Co., $3.50.

CONYNGTON—*Corporate Organization.* By Thomas Conyngton of the New York Bar. A manual for business men covering the legal features involved in incorporating a business. Third edition. 1913. New York, Ronald Press Co. $4.00.

DAGGETT—*Railroad Reorganization.* By Stuart Daggett. Boston, Houghton Mifflin Co., 1908. $2.00.

DEWING—*Corporate Promotions and Reorganizations.* By Arthur S. Dewing. Boston, Houghton Mifflin Co., $2.50.

EMERY—*Speculation on the Stock and Produce Exchanges in the United States.* By Henry C. Emery. New York. MacMillan Co., 1904. $2.00. Paper $1.50.

FISHER—*Elementary Principles of Economics.* By Irving Fisher, Professor of Political Economy, Yale University. New York. 1912. MacMillan Co., $2.00.

GERSTENBERG—*Materials of Corporation Finance.* By Charles W. Gerstenberg, Professor of Finance, New York University, School of Commerce, Accounts and Finance. New York, 1915. Prentice Hall, $5.00.

GERSTENBERG—*Syllabus of Corporation Finance.* New York, 1915. Prentice Hall. 50 cents.

HEFT—*Holders of Railroad Bonds and Notes, Their Rights and Remedies.* By Louis Heft. New York, E. P. Dutton & Co., 1916. $2.00.

HATFIELD—*Modern Accounting.* By Henry Rand Hatfield, Ph.D., Professor of Accounting, University

of California. New York, D. Appleton & Co., $2.00. By mail, $2.14.

LOUGH—*Business Finance.* By William H. Lough. The Ronald Press, New York, 1917, pp. 631. $3.00.

LYON—*Corporation Finance.* By Hastings Lyon. Complete Edition. 1916. Vols. I and II bound together. Boston, Houghton Mifflin Co., $3.00.

MEAD—*Corporation Finance.* By Edward S. Mead, Ph.D., Professor of Finance, University of Pennsylvania. New York, D. Appleton & Co., $2.25.

MONTGOMERY—*Auditing Theory and Practice.* By R. H. Montgomery, C. P. A. Second edition. 1916. New York, Ronald Press Co., $5.00.

PRATT—*The Work of Wall Street.* By Sereno S. Pratt, Formerly Secretary New York Chamber of Commerce. New York, D. Appleton & Co., $2.00.

RIPLEY—*Railroads; Finance and Organization.* By William Z. Ripley. New York, Longmans, Green & Co., 1915. $3.00.

SELIGMAN—*Principles of Economics.* By Edwin R. A. Seligman, Professor of Political Economy, Columbia University. New York, Longmans, Green & Co., $2.50.

STOCKWELL—*Net Worth and the Balance Sheet.* By Herbert G. Stockwell, C. P. A. A book for readers who are not accountants, explaining the nature of the financial statement or business "balance sheet"; what it shows, how to read it, and how it is used for the guidance of business concerns. 1912. New York, Ronald Press Co., Cloth, $1.00.

SULLIVAN—*American Corporations.* By John Sullivan, Professor of Law, University of Pennsylvania. New York, D. Appleton & Co., $2.25.

TAUSSIG—*Principles of Economics.* By F. W. Taussig, Professor of Economics, Harvard University. New York, 1911. MacMillan, 2 vols, each volume $2.00.

OUTLINE OF A COURSE IN INVESTMENT

Full titles of books referred to will be found in the bibliography at the end of the outline

OUTLINE OF A COURSE IN INVESTMENT

THIS COURSE ASSUMES A KNOWLEDGE OF THE SUBJECT INDICATED IN THE SYLLABUS OF A COURSE IN CORPORATION FINANCE

TOPIC I

What is Investment?

Chamberlain, 1–13.

Raymond, 1–4.

This first topic will serve to connect the course with the general principles of economics, and with the preceding course in Corporation Finance.

Use of capital in production.

Increasing importance of capital in production.

Theory of interest:

- Demand for capital.
- Reward for saving.
- True interest.
- Premium for risk.

Lyon, "Corporation Finance," Part I, pp. 224-232.

Commitment of capital with management.

Commitment of capital without management.

Demand for this increase with increasing complexity of economic life.

Commitment of capital with limitation of risk.

As proprietor:

Corporations—preferred stock.

Partnership—special partnership.

Individual—rental.

As lender:

Risk, Income, Control.

Lyon, "Corporation Finance," Part I, pp. 1–17, 29–30.

Relationship of Investment and Speculation.

Definition of investment for purposes of this course.

An investment is:

1. A commitment of capital for use in production;

2. Entrusted to the management of another;

3. For which the primary purpose of the

capitalist in making the commitment is to receive income by reason of the use in production (a transaction primarily for profit due to change in price is not an investment but a speculation, even though the capital so committed is used in production);

4. In which the estimated risk for use in production is not so great that the premium for risk is greater than the true interest.

For purposes of this course we will regard land as capitalized and treat it as capital.

Apply this definition of investment to:

Real estate proprietorship.

In use.

Not in use.

Mortgages.

Corporate stock.

Corporate bonds.

Municipal bonds.

(Show how government and municipal loans come under the head of commitment of capital in production.)

TOPIC II

Tests of an Investment

Chamberlain, 13-62.

Investment tests:

1. Security of principal:
    - As affected by management.
    - Judgment in making the original commitment.
   - Maintenance of assets.
     - From the nature of the business.
     - From the investment contract.
2. Stability of income:
    - As affected by management.
    - From the nature of the business.
    - From the investment contract.
3. Fair income return:
    - True interest plus premium for risk.
4. Marketability.
5. Value as collateral:
    - Depends on quickness, closeness, and stability of market.
6. Tax position.

Federal, state, and local.

7. Freedom from care.
8. Acceptable duration.
9. Acceptable denomination.
10. Appreciation.

The term "investment contract" will be used as expressing the obligations of the party (government, municipality, corporation, individual) to which or whom the use and management of the capital is entrusted, and the rights of the investor who has made the commitment of his capital.

Look up several corporations and set down the securities issued by each, find the quotation and compute the yield to show the effect of the investment contract, *i. e.*, as:

UNION PACIFIC	PRICE	YIELD
Common (8% div.)	147	5.44
Preferred 4%	83	4.82
Convertible 4%, 1927	94	4.70
First and Ref. 4%, 2008	91	4.40
First and Land Grant 4%, 47	98	4.10

Risk arising out of the nature of the business:

Security of principal.

Stability of income.

This sub-topic, stability of income, refers back to the discussion of the relative fluctuations of income from different businesses discussed in the preceding course in Corporation Finance. See *Lyon*, "Corporation Finance," Part I, pp. 50–82.

As to security of principal apply test of risk from nature of the business to several kinds of business, as for example to:

Mail order business; establishing a new magazine; owning and operating timberland; conducting an ostrich ranch; making war munitions; building railroad through new country; flouring mill; starting an electric light plant.

As to stability of income apply to several kinds of business:

Making railway equipment; street railway; the lumber business; steam railroad; gold mining; contracting business; grocery store.

TOPIC III

Government Bonds

Raymond, 5–93.

Only the general knowledge of government finance that any fairly well-informed citizen has is necessary for the special study of government and municipal obligations as investments. A more thorough-going knowledge of public finance, however, is desirable. For this subject standard large works are:

Bastable, C. F., "Public Finance." *Adams, H. C.* "Science of Finance."

Plehn, Carl C., "Introduction to Public Finance," New York, is a shorter work.

Of Bastable, especially pp. 1–220 and 612–769 should be read and of Plehn, pp. 1–102, 366–465 and corresponding Topics in Adams. The rest of these books is a discussion of taxation. Though a knowledge of the problems of taxations is desirable, it hardly has the same importance as a basis for the study of investment in the public debt as other and more general matters of public finance. For a brief

simple discussion of taxation, especially as affecting investments, see:

Lyon, "Principles of Taxation," Boston. Houghton Mifflin Co.

This was originally a report to the Investment Bankers Association.

General tests of credit applicable to all creditors:

Ability to pay.

Willingness to pay.

Ability to pay—depends on:

Capital.

Labor.

Ability to pay as applied to government obligations depends on:

Natural resources.

Productivity:

Capital.

Labor.

Population.

Number.

Moral and intellectual quality. Willingness to pay:

The willing debtor.

The unwilling debtor.

(a) When compulsion cannot be brought to bear.

(b) When compulsion can be brought to bear.

Government obligations:

- No compulsion—people cannot sue the sovereign.
- Unwillingness to pay due to change in government.
- Secured government bonds:
  - As on customs receipts—but enforceable only by consent or with force; deposit of collateral.
- Ability to pay—resources of the country.
  - Land—agricultural, forest, mineral.
  - Labor—numbers, intelligence, energy.
  - Capital—sufficient for extractive industry sufficient for manufacturing.
- Amount of debt used unproductively.
- Total debt less debt used productively equals true net debt.
- National Debt—paper money plus bonds.
- External and internal loans.

Look up New York quotations on foreign bonds and show how price is affected by investment contract as to place of payment and in

general the problem of foreign exchange in relation to foreign government.

Special foreign issues:

British consols.

French rentes.

Foreign issues dealt in the American market.

Canadian securities.

TOPIC IV

United States Government Bonds

Chamberlain, 115–122.
Chamberlain (Appendix), "A Gamble in Governments."

If the bond man studying this topic does not already have available the following:
"National Banking Act."
"Federal Reserve Act."
"Postal Savings Bank Act."
he can procure them on application to the Bureau of Printing, Washington, D. C. See list of books at the end of this outline.

United States Government Bonds:

HISTORY OF DEBT OF UNITED STATES

Present United States interest bearing debt (as of June 30, 1916.)

2% Consols 1930	$ 646,250,150
3% Loan 1908–18	198,992,660
4% Loan 1925	162,315,400
2% Panama 1916	54,611,420
2% Panama after 1918	30,000,000
3% Panama 1961	50,000,000
2½% Postal savings 31–33	5,508,060
2½% Postal savings 1935	933,540

To which there has since been added		
3½% Liberty Loan 1932–47 . . .		2,000,000,000
4% Liberty Loan 1927–42 . . .		3,000,000,000

(or more, as this goes to press the amount has not been determined).

Look up current quotations on United States Government Bonds and compute bases. (The following are as of August 19, 1916):

2% Apr. 1930	99	2.10
4% Feb. 1925	110	2.60
2% Panamas 1936	98–½	2.10
3% Panamas 1961	101–½	2.96

Explain yield differences.

Bonds available for circulation.

Tax on 2s ½%.

Tax on old 4s 1%.

3s and new Liberty loans not available.

Provisions of Federal Reserve Act for redemption of United States Bonds, and for issue of Reserve notes.

Postal savings bonds—provisions of act.

Use of bonds to secure circulation.

Freedom from taxation.

"*Federal Reserve Act*," secs. 111–118.
"*National Banking Act*," secs. 55–70.

TOPIC V

State Bonds

Chamberlain, 122-158.
Raymond, 94–139.
Secrist, "An Economic Analysis of Constitutional Restrictions upon Public Indebtedness In the United States."
Commercial and Financial Chronicle, State and City Supplement, history of state debts.
Scott, "Repudiation of State Debts."

This is an entire book on the subject which, though out of print, is available in libraries, referred to for those who want further reading. For the purpose of the course, the references to Chamberlain and to Raymond, pp. 102–128, are ample.

In considering these defaults the political situation at the time of them should be kept in mind, and the fact that the purchasers from the state governments in many cases knew the political situation.

Constitutional provisions in state constitutions on debt.

Look up and write out the provisions for your own state.

A convenient reference is to the Chronicle, State and City Supplement.
Raymond, p. 130.

Purposes of State Debt.

Look up and write out the debt statement of your own state showing the purposes for which bonds were issued.

State Credit.

Look up and make out statement of quotation and compute basis for bonds of each state. Chronicle quotation supplement.

New York—Special provision giving different basis for different issues.

Especially explain New York quotations. (The quotations given represent prices in the fall of 1916).

	Basis
N. Y. 3s 1959, $99\frac{5}{8}$	3.00
N. Y. 4s 1961, $105\frac{3}{8}$	3.75
N. Y. $4\frac{1}{2}$s 1963, $115\frac{5}{8}$	3.80

(When held as capital, surplus, etc., of savings bank, trust company, insurance company, 1% on par of 3s held and $\frac{1}{2}$% on par of 4s deducted from tax. Tax law 1903).

Explain Virginia quotations (the quotations given represent prices in the fall of 1916).

	Basis
6% deferred certfs. 1871 Brown Bros. Certfs. $53\frac{1}{2}$	
3s Riddlebergers 1932, $91\frac{1}{2}$.	3.72
3s 1991, 83	3.70

Develop history and present standing of Virginia-West Virginia controversy.
Chamberlain, 384, note, *et seq.*
Raymond, 114-118.
220 U. S. I. (Supreme Court Reports.)
238 U. S. 202. (Supreme Court Reports.)

TOPIC VI

Municipal Bonds

Chamberlain, 159–225.
Raymond, 140–161. This reading for two topics, VI and VII.

Write out quotations and compute yields for municipal bonds of ten municipalities, of essentially different populations and in different states. Chronicle quotation supplement.

Look up quotations and yields in a considerable list of representative municipals—large and small municipalities and variously distributed geographically.

Willingness to pay:

- Compulsion can be brought to bear.
  - New England—execution.
  - Generally—mandamus.

Classes of Municipals:

- County.
- City.

Town.
Districts:
  School.
  Park.
  Sewer, etc.
  Levee.
  Drainage.
  Irrigation.

Why municipalities borrow (long term) money: To equalize burden of expenditures. There is a theory that a municipality should not be in debt because non-productive. But the debt may be very essentially productive. The dollar the citizen does not have to give up in taxes he can use in his own business. But the way public business is conducted requires special restrictions. It should be hedged in by conservative principles because of the small personal responsibility. The individual goes broke in his own business if he isn't sound. But if the community is unsound in its business no particular individual suffers a sufficiently severe penalty to make the penalty a sufficient deterrent.

TOPIC VII

The Municipal Statement and Significance of the Items in It

Reading as for Topic VI.
Chamberlain, 159–225.
Raymond, 140–161.

Ability to pay.

MUNICIPAL STATEMENT CITY OF R——

Total Bonded Debt . . .			$20,747,475
Water Debt	$8,926,000		
Sinking fund	1,488,244		10,414,244
Net Debt			$10,333,231
Assessed Valuation			
Real Estate . . .	$215,285,489	(assessment about actual value)	
Personal	26,661,470		
	$241,946,959		

Tax Rate $19.73 per $1,000
Population 248,465

Look up and write out the statement for one municipality. See Chronicle, State and City supplement.

Nature of municipal assets.

Revenue-producing assets.

Sinking funds.

Debt ratio.

Assessed valuations.

Why in this country not generally up to actual value?

The tax rate of one municipality should be read in connection with the total rate including the county and state rate. A rate may be high, not only because of a low assessment but because the municipality is making improvements out of taxes instead of issuing bonds, or it may be reducing its debt by meeting the maturity of bonds without refunding. *Lyon*, "Principles of Taxation," 92–93.

Tax rate.

Its relations to assessed valuation.

Debt limitations.

Undoubtedly the existence of an absolute tax limit adversely and seriously affects the credit of municipalities which are so limited. The Ontario situation in which the municipality may not create further debt if the tax rate exceeds a limited amount is a debt rather than a tax limitation.

Look up and write out the debt limitation for your own state.

TOPIC VIII

Term of Municipal Bonds; Sinking Fund vs. Serial Maturity; Savings Bank Tests for Municipal Credit

Chamberlain, 230, Sec. 667; 213–220.
Raymond, 142–151.

Term of municipal bonds:

Massachusetts method of limiting the term by statutory requirement setting out the term permitted in accordance with the probable life of the improvement for which issued.

Canadian requirement of engineers' certificate setting forth the probable life of the improvement. The by-law authorizing the bonds must limit their term accordingly.

Serial maturity vs. sinking fund.

The uncertain value, as shown by experience, of the municipal sinking fund.

If available, the special report of the New Hampshire Tax Commission for 1916 on Municipal Finances makes a very clear statement of the difficulties of the municipal sinking fund.

The conditions stated are probably representative rather than peculiar.

General reference may be made also to the reports of the New Jersey Commission for the Survey of Municipal Financing which may be available in the bond houses.

Savings bank tests for municipal credit.

Look up the tests for municipal credit applied by the savings bank laws of New York, Massachusetts, and Connecticut. Keep in mind that these represent very severe tests, and see the reference to these tests under Topic XXV.

Select five municipalities, the population of which is up to the requirements of the savings bank investment law of New York, Massachusetts, or Connecticut, and apply the tests of one of those laws to see if the bonds of the municipalities are legal savings bank investments for that state. If any of them are not indicate what test bars them out.

TOPIC IX

Authorization, Issuance, Sale, and Validity of Municipal Bonds

Chamberlain, 225-242.

Authorization of Municipal Bonds.

State constitutional limitations and authority under legislative act, authorizing and prescribing methods of issuance.

Vote of electors sometimes required.

Vote of municipal administrative body (as city council) sometimes sufficient.

Municipality selling bonds.

There follows a form of request for information about a proposed issue of bonds by a municipality sent by a bond house to a municipality.

MUNICIPAL BOND STATEMENT
OF
BROWN, JONES & CO.

Amount to be sold............Per cent?........
Purpose of issue
Date and hour of sale........Sealed bids or auction?

Bonds to be dated..............................191
To mature......................................
....
....
Optional?
Principal where payable?..........................
Interest payable when?.............where?..........
Law issued under..................................
Denomination?....................................
Are bonds tax exempt?.............where?...........
May bonds be registered as to principal?......interest?..
Any deposits required?............................
Assessed valuation, real and personal property, for
191 ....$..........
True value (estimated) taxable property....$..........
Total bonded debt, including this issue .....$..........
Floating debt...........................$..........
Amount of bonds outstanding (included in above) issued
for Water Works, owned by City.........$..........
Sinking fund held against Water Bonds .....$..........
Sinking fund held against other bonds ......$..........
Population State or U. S. Census, 191..................
Population estimated........191.......................

Private Sale—sometimes not permitted by legislative act.

Public Sale.

Advertising for bids.

All or none bidders.

Awarding the bonds.

Bid price must be par or better, European practice not so.

There is perhaps the beginning of a willingness with us to permit municipal bonds to be

sold at a discount. Minnesota, for example, permits it under some circumstances.

See *Fischer*, "Selling Over the Counter"—Investment Bankers Association Annual Report, 1913.

There is an interesting Dutch method by which all bonds are allotted at the lowest bid accepted. Those who bid higher than the lowest bid are given full allotments at the lowest price. This seems equitable. All get their bonds at one price and one purchaser has no advantage over another in re-selling.

Reasons for holding municipal bonds invalid:

1. The legislative act relied on held unconstitutional.

2. Exceeding limit of indebtedness.

3. Lack of statutory authority.

4. Statutory requirements for proceedings not complied with.

Validating Acts. (It should be said in connection with validating acts that they cannot override constitutional provisions, and that a complicated procedure leading to delays in operation may make them something of a nuisance.)

Georgia has a validating act.

Opinion of Attorneys General as to legality, Texas and Oklahoma.

Certification of bonds for genuineness of signature and as within the limits authorized.

Done by certain trust companies.

By state of Massachusetts for municipal notes.

TOPIC X

General Considerations of Municipal Credit; Municipal Bonds and Taxation; Special Markets for Municipals; Municipal Repudiation

Chamberlain, 173–179, 237.
Raymond, 152–153, 159.
Chamberlain, Sections 699, 704, 705, 707.
Wrightington & *Rollins*, "Tax Exempt and Taxable Investment Securities."

(At the moment of writing out of print, but may be republished by Financial Publishing Co., Boston.)

Municipal repudiation.
Chamberlain, 173, 179.
Raymond, 152–153.

Examples.

Causes.

Results in credit.

General considerations of municipal credit.
Chamberlain, 237.
Raymond, 152–153, 159.

Character of population.

Record of good faith.

Location, prosperity, and probable future growth of the community.

Municipal bonds and taxation.

Chamberlain, Sections 699, 704, 705, 707.

Exemption from state and local taxation.

Exemption from Federal income tax.

Income from municipal bonds is not subject to either the normal tax or the surtax, and does not have to be reported.

Reasons for exemption from Federal income tax.

Federal government has no constitutional right to tax an agency of a state government.

Are the municipal bonds of your own state subject to taxation in the state? Look up in State and City supplement in the "Chronicle."

Special markets for municipals:

- Savings banks.
- Trustees.
- Postal savings funds.
- Rich investors (to avoid taxation).

TOPIC XI

Tax Districts; the Problems of Overlapping Debt Areas; Special Assessment Bonds

Chamberlain, pages 243–251, 205–211.
Chamberlain, sections 483, 722–726, 532, 576.

Overlapping government areas and the problems of total debt against given values.
Chamberlain, 205–211.

Tax Districts.
Chamberlain, 243–251.

As a means of escaping debt limitations.

A special report of the New Hampshire Tax Commission in 1916 on Municipal Finances presents a good discussion of the general topic.

Practice work—Take a given municipal area, as a county, and compute the total debt percentage of the values, taking all the debt for which the values are liable. Allot to the area a part of the state debt in the proportion of the state valuation to the valuation of the area taken. State and City supplement of the "Chronicle" will furnish the material.

Special assessment bonds.
Chamberlain, Sections 483, 722–726, 532, 575.

Reasons for issuing special assessment bonds. True special assessment bonds—*i. e.*, which have a claim only against the abutting property.

Municipal special assessment bonds, *i. e.*, bonds which are a general obligation of the municipality, but for which the municipality holds the abutting property liable.

Special assessment bonds are not taxed under the Federal Income Tax.

Practice work—Examine the debt of a municipality of 250,000 inhabitants or over and make out a list of the various purposes for which the municipality has incurred bonded debt. State and City Supplement, "Chronicle."

TOPIC XII

Buying and Selling Securities

"You and Your Broker," 35–58.

Buying a bond:

The order—to salesman or by mail or in person over the counter.

Where delivered—at bank—but may even be brought around personally by salesman.

How delivered:

Shipped by express, or

Registered mail insured.

Express company an insurer.

How insured if mailed.

Draft attached:

(Just like the shipment of any goods except that here the goods themselves are attached to the draft instead of a bill of lading which it is necessary to have in order to get delivery of the goods.)

Computation of prices:

Sold at a price and accrued interest.

Sale and transfer of bonds.

Registered.

Coupon.

Business of safe deposit company.

Inheritance tax—notice to comptroller, but New York case, Appellate Division, has said that securities in safe deposit box are not in custody of safe deposit company. The practice of giving notice nevertheless continues.

TOPIC XIII

Real Estate Mortgages as Investments

Chamberlain, 46–61.

Though the bond man himself is not dealing in real estate mortgages, they constitute a competitive investment, and he should know something about them.

The real estate mortgage as an investment.

Our land capital financed by borrowing just the same as any other capital.

Nature of a mortgage as security.
Rights under—reviewed by reading ordinary form of mortgage.
Gerstenberg, "Materials of Corporation Finance," 176.

Form of Mortgage:

Consideration.

Description (location).

Granting clause.

Defeasance clause.

Right of sale on default (foreclosure).

Covenant to keep insured.

Principal due on default in interest.

Further assurance—to execute any further instruments, etc.

Right of entry on default, and to apply income to payment of debt.

Right to receive on default.

Right of mortgagee to pay taxes and covenant of mortgagor to repay. (Usual provision in New York City mortgages that the mortgage becomes due on any change in the tax law affecting it.)

Equities—Savings bank and trustee requirements for State and City Supplement, "Chronicle."

TOPIC XIV

Investing in City Mortgages

Practical Real Estate Methods. Read the following chapters:

Mortgage loans on real estate.

Margins on mortgage loans.

Building loans.

The city mortgage:

Business building.

Dwelling.

Vacant lots.

Appraisals:

Correct appraisals based on actual selling price, not on capitalized earnings.

Who makes—reliability of.

Buyer selects own appraiser or insists on one he knows.

What proportion of value in land and in building makes the best basis for security?

Rates of income.

Application for loan.

Putting through transaction.

Investigation of physical security discussed in previous topic.

Personal obligor.

(Generally not much regarded in New York but may become important.)

Title:

Title guarantees in New York and some other places.

Fees for New York County first examination $65, plus $5 for each $1,000, up to $40,000. Then $2.50 a $1,000.

Reissue title insurance, New York County: $32.50, plus $5 a $1,000, plus $2.50 per $1,000 for over $40,000.

Of course these figures quoted by a New York company for New York County on a certain date are given merely as an approximate indication of this business.

Disbursements:

Title search or insurance.

Appraisal fee.

Survey fee.

Recording tax.

Drawing up documents.

Brokers fee 1% and up.

Lending on new mortgage:

Purchase money.

New loan.

Builder's mortgage.

(Advanced as building goes up.)

Insurance:

Taxes and tax liens.

Taking mortgage by assignment. (Covenant that there is due and owing the stated sum.)

Form of Assignment.

Sale of property subject to mortgage. (Does not release original obligor but puts him in the position of guarantor, but mortgagee may, if he wishes, release original obligor.

Work of the mortgage broker:

How he finds borrowers.

How he finds lenders.

Who does the work:

Brokers.

Mortgage companies.

The real estate and trust fund law firms.

The amortized mortgage running for longer time.

Mortgage bonds—collateral mortgages.

Mortgage bonds—on single buildings.

The guaranteed mortgage, ½% for guarantee and care.

A form follows, showing elements to be considered in making a mortgage investment.

APPLICATION FOR LOAN ON BUSINESS PROPERTY

Robert Jones applies to the City Savings Bank for a loan secured by first mortgage on property described below:

First mortgage—$42,000 at 5% for three years
Obligation—Robert Jones
Location—Worcesterfield, N. Y., 107 Main Street
Dimensions of lot—62.3′ x 121 feet
Dimensions of building—62.3′ x 85 (about)—Stories—one story; Walls for three stories
Condition of building—Good.
Building materials—Brick
Present use—Stores—all rented.
Annual rent—$5,000.

Owner's value	$65,000	
Assessed value, 1916, Land		$50,000
Building		9,000
		$59,000

TOPIC XV

Farm Mortgages and Land Bank Securities

Robins, "The Farm Mortgage Handbook."
The Federal Farm Loan Act, 64th Congress, 1916.

The Federal Government had some interesting material prepared while farm loan legislation was under consideration, especially:
Thompson, C. W., "Factors Affecting Interest Rates and Other Charges on Short Time Farm Loans."
Thompson, C. W., "Costs and Sources of Farm Mortgage Loans in the United States."

Farm Mortgages.

Rural credits legislation, federal and state.

Rates.

Who invest in:

Insurance companies.

Savings banks (Vermont).

Farm mortgage association.

Farm mortgage bankers and their methods.

The following chapter headings from Mr. Robins's book indicate the scope of the subject. This little book may very profitably be read through. It is ex-parte, giving a view of the subject by a dealer in the security, but an excellent statement.

Rural credits.

The negotiation of farm mortgages.

The marketing of farm mortgages.

Investors in farm mortgages and the record of the farm mortgage as an investment.

The qualities of a farm mortgage as an investment.

Essential differences between mortgages on farms and mortgages on urban real estate.

SECTION II

INVESTING IN CORPORATION SECURITIES

For information about corporations and their securities, constant reference should be made to such reference books as:

Poor's Manuals.
Corporation Service Manual.
Moody's Analyses.
Manual of Statistics.
Commercial & Financial Chronicle, Weekly and Special Supplements.

For quotations:

Quotation Supplement, Commercial and Financial Chronicle.

Quotation record in the weekly Commercial and Financial Chronicle.

TOPIC XVI

General Investment Considerations of Corporation Securities

Chamberlain, 69–114.

Nature of business:

Is it a fixed capital or non-fixed capital business; *i. e.*, is the income from the service or from the product the larger proportion of the return for the use of the fixed capital? If the use of fixed capital plays a relatively large part in the cost of service or product probably the investment is on a sounder basis, other things being equal, than if fixed capital plays a relatively small part. Compare a railroad or hydraulic electrical company with a mercantile concern dealing in circulating capital, or a mail order house which has expended funds in building up good will.

Select a railroad, an electric lighting company, a manufacturing concern, and determine the percentage of gross earnings available for distribution to the various classes of securities.

The nature of the business risk:

Are earnings subject to wide fluctuations?

Review the discussion of fluctuations in gross due to the nature of the business presented in the Corporation Finance course under Capitalization in Relation to Earnings.

Lyon I, 50.

Stability from the nature of the business: *i. e.*, is it dependent on fashion, etc.?

Character of Management, etc.

Evidence of Ability, Integrity.

Chamberlain, 254.

Location of Business:

Is the location advantageous for the business to be carried on—location of manufacturing plant with reference to raw materials and market—location of railway or street railway with reference to sources of traffic?

Chamberlain, 320–327.

The Investment Contract:

Claim it gives on income.

Claim it gives on assets.

Where would the investment stand in the event of insolvency and a sale of assets? (These two headings of course cover a very large part of the whole subject of Corporation Finance and Investment in Corporation Se-

curities. By way of review of topic, *Heft*, "Holders of Railroad Bonds and Notes," pp. 227–334, could be read.)

Effect of the Investment Contract as shown in yield of different securities of the same corporation.

This variation of yield in accordance with the investment contract was suggested in the earlier Topic No. IX. Since, however, it is a large part of the basis of investment in corporate securities, it needs to be taken up again at this point.

Work out the corresponding showing for the securities of several corporations, as say, the Union Pacific, United States Steel, Interborough Rapid Transit, or any that are locally more interesting.

TOPIC XVII

Stock as an Investment

Chamberlain, Chap. IV, pp. 29–37.

"Stocks and the Stock Market," annals of the American Academy of Political and Social Science, contains articles on investment in the stock of corporations engaged in various kinds of enterprises.

Element of potential appreciation.

Combination of anticipated profit with expected income. A combination of speculation and investment. See definition of investment under Topic No. I.

Element of risk.

Price in relation to:

Dividends.

Earnings available for dividends.

Surplus.

(For a general discussion of the relation of the stockholder to corporate income see *Lyon*, "Corporation Finance," Part II, 17–34, 175–195.)

Look up the price and yield of a common stock in each of these classes: Of a corporation distributing as dividends nearly all its income available for dividends; of a corporation not paying any dividends in relation to earnings available for dividends; of a corporation paying in dividends only part of the earnings available for that purpose, and present the results in the following form:

NAME OF CORPORATION	PRICE OF STOCK	PER CENT. PAID IN DIVIDENDS	PER CENT. OF NET EARNINGS CONSUMED IN FIXED CHARGES

PER CENT. EARNED AVAILABLE FOR DIVIDENDS	PER CENT. OF ACCUMULATED SURPLUS ON THE STOCK	INCOME RETURN TO THE PURCHASER

Preferred stock.

Report in the same form as above on three preferred stocks paying the full preferred dividends.

Report in the same general form on a preferred stock which is cumulative and not paying dividends, indicating the amount of accumulated dividends.

The value of stock in relation to the percentage of net earnings consumed in fixed charges.

Select the stock of three corporations as nearly alike as you can find in other respects indicated in the report form just given, but differing in the per cent. of net consumed in fixed charges, and compare prices.

TOPIC XVIII

Bonds as an Investment, and Further General Investment Principles; Assets, Their Maintenance, Increase, or Decrease

Report of the Public Service Corporation Committee of the Investment Bankers Association for 1916.

Chamberlain, 263–291.

General principles of the relationship of gross, net, and fixed charges from the viewpoint of investment values.

Ratio of net to fixed charges:

If taken alone might be larger by reason of skimped maintenance and not permanently maintainable.

Ratio of gross to fixed charges:

If taken alone a corporation having a large true operating ratio (*i. e.*, one in which the capital account is not being added to through the appearance of maintenance) might show a large ratio of gross to fixed charges without having a margin of safety of net earnings above fixed charges.

Combined ratios of gross and net to fixed charges may be used as a test of sufficient maintenance and a sufficient margin of safety.

Debt in relation to assets:

Equities in relation to value of assets regarded as sufficient margins of safety in assets.

Public service corporations.

Railroads (debt per mile).

Manufacturing concerns.

The mortgage (Trust Deed or other investment contract) open or closed. If open does it contain sufficient safeguards to protect the investor's equity?

Blanket or not:

If not a blanket mortgage what is the relative importance of the property covered and its proportion to the whole?

First mortgage bonds.

Junior bonds.

Refunding bonds.

Underlying bonds.

What could happen on default and in foreclosure?

Possible prior liens of receiver's certificates.

Other possible prior claims.

Heft, "Holders of Railroad Bonds and Notes," 227–234.

Apply the tests of the ratios of gross and net to fixed charges to two railroads, two public utilities, and two manufacturing concerns.

Importance of maintenance account.

A determination of the proper per cent. of earnings on investment for adequate maintenance is primarily an engineer's problem. Very little general information is available. There is a considerable body of information for railroads and there is beginning to be information for public utilities. But here is an open and good field for financial study in investigating the amounts actually expended in maintenance for different classes of enterprises, and in tracing the result in the showing for the properties to see whether an increasing cost of operation indicates a decreasingly efficient plant. It is to be hoped that students of finance will work on these problems and that we shall have a growing body of information. The discussions under this topic consider only general principles.

Maintenance account:

Are assets maintained through this account?

Are assets decreasing because of insufficiency of this account (milking the property)?

Are assets increasing through an excess

maintenance account (fattening the property)?

Take two railroads and work out the per cent. of gross expended in maintenance back for a period of five or more years.

Surplus account:

Are assets from which future earnings are to be made being increased through a surplus account?

TOPIC XIX

Railroad Securities—Investment Considerations

Chamberlain, 252–262.
Chamberlain, 263–292. (Previously assigned under topic XVII.)
Chamberlain, 292–313.
Moody, "How to Analyze Railroad Reports, 4th Edition," 1916. New York, Moody's Investors Service.
Brinton, Willard G., Chapter XV on "Corporation Financial Reports in Graphic Methods for Presenting Facts," New York, 1914. *Engineering Magazine* contains some interesting comment on analyses of financial reports.

Reducing statistics to mileage basis for purpose of comparison.
Moody, "How to Analyze Railroad Reports."

Debt per mile—total and for each lien.

Income per mile.

Tests for efficiency of operation.

Combination of:

Efficiency of plant.

Efficiency of management.

Efficiency of plant:

Track—single or multiple.

Curvature.

Gradient.

Territory served:

Density of traffic statistics.

Character of traffic:

Low grade or high grade freight.

Diversification of traffic.

Efficiency of operation:

Ratio of cost of conducting operations.

Ten miles per train mile.

Property covered by lien (relative importance to system):

Main line track.

Terminal entrance.

Bridges.

Branch lines.

EQUIPMENT BONDS

Chamberlain, 192–214.

Character of equipment on which bonds are secured.

Term and amortization—standard—*i. e.*, equal serial not running for more than ten years.

Amount of equity provided by first payment.

Report on the terms of an equipment issue. Look up in the manuals a road which has an equipment issue outstanding and from the probable date of its issuance look up its terms in the Chronicle by going back to the number of the Chronicle of that date.

TERMINAL BONDS

Chamberlain, 93.
Lyon, "Corporation Finance," Part I, 140-143.

How many and what railroads use the terminal?

Operating agreement.

Providing for the capital charge of terminal through an operating agreement, and not becoming directly joint obligor on the bonds, makes it unnecessary to show the cost of the terminal as a liability. This practice increases the operating cost but decreases the capital charge on which to show earnings.

Look up the operating agreement and terms of some union terminal.

TOPIC XX

Investment Problems Involved in the Holding Company

Lyon, "Corporation Finance," Part II, 196–208. (This is a review of an assignment in Corporation Finance Course.)

and

Classes of Public Utilities. Public Service Commissions and Investment.

Securities of a holding company, and the value of "other income" (*i. e.*, income derived from the ownership of the securities of other corporations) as earnings available for charges or dividends.

Collateral bonds, or holding company securities.

Pledge of stock and agreement not to increase the debt of the subsidiary. If such an agreement exists the holding company bonds have the effect of a fixed claim junior to the bonds of the subsidiary on the tangible assets from which the gross income is derived.

Percentage of gross of subsidiaries consumed in charge of subsidiaries before earnings of subsidiaries are available to pay charges of holding company.

Take an example of a holding company, for which the information is available, and work out the per cent. of total gross and net of subsidiaries consumed in fixed charges of subsidiaries and the per cent. consumed in the fixed charges of the holding company.

Bonds of subsidiaries:

Investment problem is the same generally as for a separate corporation.

But possibility of building up some subsidiaries at the expense of others and squeezing the bond holder of a particular subsidiary.

Securities of a lessor corporation:

Power of receiver to cut off the lease.

Is the lease under such conditions for a long enough term to remove the desirability of lessee milking assets of lessor?

Direct and assumed obligations.

Guaranteed obligations.

Guaranteed by endorsement and otherwise.

PUBLIC SERVICE CORPORATIONS

Classes of public utility corporations:

Street railways.

Urban.
Interurban.
Electric.
  Light.
  Power.
    Hydraulic Electrical.
Gas.
  Natural.
  Artificial.
Telephone.
Telegraph.
Water.

PUBLIC SERVICE COMMISSIONS AND INVESTMENT

Policy as to allowance of rates for income return, valuation of property, etc.

Policy as to competition (Certificate of public convenience and necessity).

Policy as to regulation of capitalization.

The natural monopoly idea applied to public service companies.

TOPIC XXI

Investment Considerations of Street Railway, Gas, Electric Light, and Power Companies

Chamberlain 320–349, 357–365.

Interurban.

"Electric Railway Bonds as Investments, Bonds as Investment Securities." Annals American Academy of Political and Social Science.

Street railway securities:

- Urban.
- Interurban.
  - Competition with steam railways.
  - Union of steam and electric railways.

Gas company securities:

- Relatively long history.
- Competition with oil and electric light.

Electric light securities.

Power company securities.

- Climatic conditions—rainfall:
  - Minimum power.

Minimum power for ten months', etc., period.

Drainage area.

Head.

Cost per horsepower.

Market for power.

Amount of power marketable.

Price per horsepower.

Compare the quotations on the securities of street railway, gas, electric light, and power companies. Select for comparison one company of each class, and select companies which as near as may be have about the same earnings and the same proportionate fixed charges.

TOPIC XXII

Investment Considerations of Street Railway, Gas, Electric Light, and Power Companies

Chamberlain, 314–319, 375–383, 384–404.

TELEGRAPH AND TELEPHONE SECURITIES

Telegraph companies.

Telephone companies.

The "Bell" companies; The American Telegraph and Telephone Company and its securities, and the securities of subsidiaries. The "Independent" companies.

Importance of a telephone "area."
Toll service.

STEAMSHIP SECURITIES

Chamberlain, 314–319.

Blanket mortgage steamship bonds.

Great Lakes—single boat bonds.

Importance of insurance.

TIMBERLAND SECURITIES

Chamberlain, 375–383.

Form—Ten-year series.

Sinking fund:

Effect of period of poor demand for timber on the bonds, considering the expectation of meeting the maturity from the proceeds of the annual cut.

Estimate of values.

The work of the "timber cruiser."

The fire hazard.

Southern timberland.

Pacific Coast timberland.

RECLAMATION SECURITIES

Chamberlain, 384–404.

"Reports, Committee of Investment Bankers Association in Annual Reports of Association."

Irrigation District Bonds.

Private Project and Carey Act Bonds.

Drainage and Levee Bonds.

TOPIC XXIII

Industrial Securities

The comparative average meagreness of industrial reports, and the wider variety of considerations make the industrial a vaguer topic for study than railroads. Since the amount of discussion in print of the general problems of investment in industrials is meagre it is not possible to present an extensive outline for study of that topic.

Collver, "How to Analyze Industrial Securities."

Dewing, "Corporate Promotions and Reorganizations." (This is, for industrials, somewhat in the nature of a companion book to Daggett on "Railroad Reorganizations.")

Industrial Reports.

Collver, 1–8.

Industrials compared with railroads.

Collver, 9–12.

What is included in the term Industrials:

Collver, 13–16.

Manufacturing.

Merchandising.

Not mining.

Large and small scale business.

Collver, 17–20.

Business considerations:

Fluctuation in demand for product.

Diversification of product.

Integration of product, *i. e.*, from raw material to user of final product.

Standardization of product.

Advantages of location.

Competition.

Collver, 21–45.

Questions of management.

Collver, 47–68.

Financial connections.

Interpreting the balance sheet of an industrial:

Lack of uniformity.

Certificate of public accountants.

Good will.

Patents, trademarks, brands, rights.

Current assets.

Current liabilities.

Surplus.

Collver, 69–164.

Interpreting the income account of an industrial.

The income account and importance of consistency in form.

New enterprises.

Collver, 189–204.

Elements of risk and safety due to the nature of a particular kind of business.

Elements of risk due to competitive nature of the business.

Value of fixed assets.

Value of quick assets.

Stipulations for maintaining quick assets.

TOPIC XXIV

Mathematics of Investment

Chamberlain, 405–425.
Sprague (Perrine), "Accountancy of Investment."

The life tenant and the remainderman.

Income to the life tenant, principal to the remainderman.

Principal and income.

What is principal and what income?

Stock dividends.

A very good discussion of the stock dividend from this standpoint sufficient for the purposes of the course may be found in Montgomery, "Income Tax Procedure," 87–89. The bond man should, if possible, determine the situation in his own state. This, however, is difficult, as there is no general treatise to which he can be referred.

The student should have a clear understanding of the following subjects, and he might

well be able to work out the mathematical formulae. He should understand their bearing on the matter of basis or true income return.

Simple and compound interest.

The value or amount of a dollar at a given rate of interest for a given number of interest periods.

The amount of compound interest for a number of interest periods at a given rate of interest.

The present worth of a dollar at a given rate of interest for a given number of interest periods.

Simple and compound discount.

Annuities.

Amount of annuity.

Present worth of an annuity.

Rent of an annuity.

TOPIC XXV

A. Investments of Trustees
B. Investments of Savings Banks

(See State and City Supplement of the Commercial & Financial Chronicle for laws governing trustee investment in many states.)

Loring, "Trustees Handbook," 109–142.

Though this little handbook is now not up to the latest statutes and decisions, it concisely and simply states the principles involved. The pages cited cover the investments and disposition of special dividends. A bond man would find it well worth while to read this entire little volume of 193 pages.

INVESTMENTS OF TRUSTEES

Classes of trustees:

Trustees for individuals under wills or other documents creating trusts.

Guardians.

Trustees for educational and charitable institutions.

The nature of the investments of a trustee

may be determined by the instrument creating the trust.
Loring, 112.

Legal investments for trustees in the absence of express instructions in the document creating the trust.
Loring, 113–115.
State & City Supplement, "Chronicle," for various states.

Classes of investments disapproved.
Loring, 115.

Duties of the trustee in the management of the investments: Duty to keep the fund invested.
Loring, 109.

Principal and income.

Life tenant and remainderman.
Loring, 121–142.

Dividends:

Current.

Extra.

Stock.

Loring, 126–135.

Bonds bought at a premium.
Loring, 136.

Bonds bought at a discount.

Make a written report on what constitute legal trustee investments in your own state.

INVESTMENTS OF SAVINGS BANKS

(See State & City Supplement of the Commercial & Financial Chronicle for laws governing the investment of savings bank funds for the several important savings bank jurisdictions.)

The savings bank as developed in New York and in the New England States may require a word of explanation for those who are not familiar with its purposes. These savings banks are mutual institutions, not for profit. The whole fund, deposits and surplus, is a trust fund for depositors. The law governing the investment of the fund has been a matter of historical development, and should be considered in that light, and not as a group of scientific principles for tests of credit, by which all securities excluded are necessarily inferior to those included. For example, the New York law includes as a legal investment bonds of the New Jersey cities of Bayonne, Hoboken, and Jersey City, but excludes the bonds of Hudson County in which all these places are located. It may be considered generally, however, that those bonds which are included as legal savings bank investments are worthy of high credit.

The Mutual Savings Bank.

Limitations on deposits.

Limitations on withdrawals.

A commercial bank, national or state, with capital stock, engaging in business for profit may be permitted to assume greater risks for the sake of profit because the risk falls primarily on the stockholders who are making the profit.

Legal restrictions on savings bank investment.

The law of New York (or any other jurisdiction of more immediate interest to the bond man) on savings bank investment.

(Make a comparison between two savings bank investment laws, showing any differences in the severity of the tests applied.)

TOPIC XXVI

Investments of Insurance Companies

A bond man should be familiar with the law governing the investment of the funds of insurance companies in his own state.

Zartman, "The Investments of Life Insurance Companies."

Wolfe, "The Examination of Insurance Companies."

These books contain much more information about insurance matters than it is necessary for a bond man with a general clientele to know. It is suggested, however, that a bond man having to deal with insurance companies may very profitably read them throughout.

Classes of insurance companies:

Fire.

Life, fraternal orders.

Fidelity.

Casualty.

Plate glass.

Funds to be invested.

Capital.

Premiums.

Character of investments.

For life insurance companies see report of Robert Lynn Cox, as counsel to the Association of Life Insurance Presidents, printed in part in *Robins*, "The Farm Mortgage Handbook."

Zartman, p. 9.

The bond man studying this topic should have access to the report of his own state insurance department.

Assets of an Insurance Company:

Cash.

Deferred and outstanding premiums.

Accrued interest.

Premium notes.

Policy loans.

Mortgage loans.

City.

Farm.

Real estate (usually limited to real estate in which the company conducts its business).

Collateral loans.

United States bonds.

Foreign public bonds.

State bonds.

County and municipal bonds

Railroad bonds.

Public utility bonds.

Miscellaneous bonds.

Railroad stocks.

Public utility stock.

Miscellaneous stock.

(Take the investments of an insurance company and determine the percentage in each of these items.)

Requirements for the deposit of securities to protect the business done in the jurisdiction.

TOPIC XXVII

The Investments of National Banks, State Banks, and Trust Companies

The commercial loan aspect of commercial bank investment, which is the principal part of such investment, is not, of course, of primary importance to the bond man. It is important, however, that the man who comes in contact with the commercial banks to have a general understanding of this matter so that he may understand the commercial banker's problem and be able to meet him intelligently. And for any bond man this understanding should be a part of his general financial knowledge. So here are presented some of the considerations of investment in commercial paper. This topic opens the whole problem of commercial banking. Of course it is necessary to limit the consideration of it very closely. Read any work on banking that treats of bank credits.

Special importance that assets be liquid. (Investment test, "convertibility.")

Commercial paper.

Bills or notes based on a commercial transaction representing goods in the course of consumption (circulating capital) are a liquid asset by reason of their frequent maturity and the possibility of rediscount.

General credit considerations.

The work of the note broker.

Liquidity through rediscounting.

Law authorizing National Bank investments.

May not make investments in, or secured by, real estate, except for premises on which to transact its own business and as security for or taken for antecedent debts (Nat. Bank Act, Sec. 513).

May not loan more than one-tenth of capital and unimpaired surplus funds to any one borrower.
(National Bank Act, Section 5200.)

(The bond man should look up the law regulating the investments of state banks and trust companies in his own state.)

Investments of Postal Savings Banks.

Investments of banks in bonds as secondary reserve.

Secondary reserve—meaning of term.

Character of bonds—marketability—active listed.

TOPIC XXVIII

General Principles of Investment; Fraudulent and Investment Schemes

GENERAL PRINCIPLES OF INVESTMENT

Distribution of risk:

Limiting proportion of capital invested in any one investment.

Limiting the proportion of capital invested in any one kind of enterprise.

Distributing investments over more than one geographical area.

Selecting investments having varied dates of maturity.

(Analyze some list of investment holdings from these viewpoints.)

FRAUDULENT INVESTMENT SCHEMES

Types of offerings which should arouse suspicion.

Gerstenberg, "Materials of Corporation Finance," 377–403.

Warnings in an investment offering:

The promise of exceptional returns.

Dwelling on the large profits made in other enterprises.

Work of the post office department in suppressing fraud.

"Blue Sky Laws."

Contrasting types of legislation as acts of various states of the United States which interpose an official supervision of investment offerings, compared with the requirements of such legislation as the English Prospectus Act which seeks the same result by requiring a publication of facts.

TOPIC XXIX

Investments and Taxation

Lyon, "Principles of Taxation" (Report to Taxation Committee, Investment Bankers Association).

A bond man should know precisely the law of his own state covering the taxation of all classes of investments. He should also be familiar with the Federal Income Tax law and especially with its treatment of income from state and municipal bonds and from dividends.

Montgomery, "Income Tax Procedure."

State and local taxation.

The general property tax.

Lyon, "Taxation," 31–58.

The classified property tax.

Lyon, "Taxation," 73–89. (Especially footnotes.)

The income tax as a form of state and local taxation.

Wisconsin and Massachusetts Income Tax Laws.

Lyon, "Taxation," 15 (though the objections to an income tax seem valid, perhaps they are given too much weight as compared with the advantages).

Inheritance taxes as affecting investments.
Lyon, "Taxation," 108–112.

Investments which are exempt from state and local taxes.

Usual exemption by a state of its own state and municipal bonds from state and local taxation.

The Federal Income and Inheritance Tax:

Tax covenant bonds, *i. e.*, bonds on which the corporation which issued them covenanted to pay free from any tax which the corporation might be required to withhold.

The exemption of income from state and municipal securities—on the principle that it is not constitutional for the Federal Government or a state government agency to tax the securities of each other.

The treatment of dividends in the Federal Income Tax law and why.

TOPIC XXX

Economic Conditions and Investment

Chamberlain, 455–512.
"America's Changing Investment Market." Annals of the American Academy of Political and Social Science.

Statistical figures:

- Building statistics.
- Bank statistics:
  - Clearings.
  - Reserves.
  - Money rates.
- Business failures.
- Immigration and emigration.
- Imports and exports, balance of trade and gold movements.
- Gold production and the quantity theory of money. $MV = PT - M'V'$
- Commodity prices,
- Crop conditions,

Corporation earnings.

The relation of security prices to interest rates.

Interest rates an index of the demand and supply of capital, depending on general credit conditions.

BOOKS REFERRED TO IN OUTLINE OF COURSE IN INVESTMENTS

ADAMS—*Science of Finance.* By H. C. Adams, New York, H. C. Holt & Co. 1899, $3.00.

BASTABLE—*Public Finance.* By C. F. Bastable, New York, MacMillan & Co. 1903. $3.50.

CHAMBERLAIN—*The Principles of Bond Investment.* By Lawrence Chamberlain. 1911. New York. Henry Holt & Company.

COLLVER—*How to Analyze Industrial Securities.* By Clinton Collver. New York, 1917, Moody's Investors Service. $2.50.

DEWING—*Corporate Promotions and Reorganizations.* By Arthur S. Dewing. Boston. Houghton Mifflin Co., $2.50.

GERSTENBERG—*Materials of Corporation Finance.* By Charles W. Gerstenberg, Professor of Finance, New York University, School of Commerce, Accounts and Finance. New York. 1915. Prentice Hall, pp. 1008, $5.00.

HEFT—*Holders of Railroad Bonds and Notes, Their Rights and Remedies.* By Louis Heft. New York. E. P. Dutton & Co. 1916. $2.00.

LORING—*A Trustee's Handbook.* By Augustus Peabody Loring. Boston. Little, Brown & Co. 1907, $2.50.

LYON—*Corporation Finance.* By Hastings Lyon. Complete Edition. 1916. Vols. I and II bound together. Boston. Houghton Mifflin Co., $3.00.

LYON—*Principles of Taxation.* By Hastings Lyon. Boston. Houghton Mifflin Co., 75 cents.

MONTGOMERY—1917. *Income Tax Procedure.* By Robert H. Montgomery, C. P. A. New York. Ronald Press Co. $2.50.

National Bank Act, as amended, Federal Reserve Act, as amended, and other laws relating to National Banks, July 1, 1915. Washington, Superintendent of Documents, 25 cents.

Postal Savings Banks Regulations for Guidance of Qualified Banks, etc. Includes text of act. 1913. Washington. Superintendent of Documents, 5 cents.

PLEHN—*Introduction to Public Finance.* By Carl C. Plehn. New York. The MacMillan Co., pp. 480. 1911. $1.75.

RAYMOND—*American and Foreign Investment Bonds.* By William L. Raymond. Boston. 1916. Houghton Mifflin Co., $3.00.

ROBINS—*The Farm Mortgage Handbook.* By Kingman Nott Robins. New York. 1916. Doubleday, Page & Co., $1.25.

SECRIST—*Bulletin of the University of Wisconsin No.* 637, *Economics and Political Science, Series Vol.* 8, *No.* 1. "An Economical Analysis of Constitutional Restrictions upon Public Indebtedness in the United States." By Horace Secrist, University of Wisconsin. 1914. 40 cents.

SPRAGUE—*The Accountancy of Investment.* By the late Charles E. Sprague, C. P. A. Revised by Leroy L. Perrine, C. P. A. Third Edition, 1914. New York, Ronald Press Co., $5.00.

Stocks and the Stock Market. Annals of the American Academy of Political and Social Science. Philadelphia. 1910, $1.50.

THOMPSON—*Costs and Sources of Farm Mortgage Loans in the United States.* By C. W. Thompson. Washington. 1916. Apply Bureau of Printing.

THOMPSON—*Factors Affecting Interest Rates and Other Charges on Short Time Loans.* By C. W. Thompson. Washington. 1916. Apply Bureau of Printing.

VARIOUS AUTHORS—*Bonds as Investment Securities.* American Academy of Political and Social Science. 1907. $1.50.

VARIOUS AUTHORS—*Practical Real Estate Methods.* Thirty chapters written by different authors. New York. 1914. Doubleday, Page & Co., $2.50.

VARIOUS AUTHORS—*You and Your Broker*, Magazine of Wall Street. New York. 1917. $1.00.

WOLFE—*The Examination of Insurance Companies.* By S. Herbert Wolfe. New York. 1910. The Insurance Press, $3.00.

ZARTMAN—*The Investment of Life Insurance Companies.* By L. W. Zartman. 1906. New York. Henry Holt & Co., $1.50.

The Philadelphia Commercial Museum maintains a financial department open to subscribers, from which they may obtain financial information.

THE COUNTRY LIFE PRESS
GARDEN CITY, N. Y.